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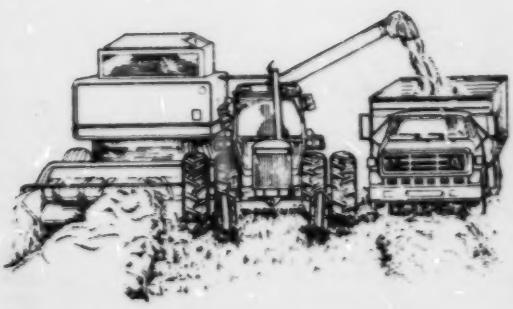

Managing Your Farm Income Tax Plan

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Foreword

By using well thought out tax management strategies, a farmer can significantly increase his after tax net income. Income Tax Management for Farmers simplifies the complex world of income tax to help farmers save income tax. This bulletin can be of benefit to both farmers who do their own income tax and those farmers who hire an accountant for this task.

Good records are the key to successful tax management. A section of this bulletin deals with this major requirement.

The tax management strategies and hints outlined in the bulletin enable farmers to minimize their income taxes by planning and management, both within the taxation year and at tax filing time.

This publication is based on tax laws in effect to the date of printing. Any tax changes occurring after this date may affect the contents of this publication. Although the information presented here has been reviewed for accuracy by Revenue Canada — Taxation, readers are cautioned to check with Revenue Canada about specific concerns.

For convenience, useful addresses for tax information sources are listed in the bulletin. As well, a glossary of tax terms is included.

This bulletin has been prepared by the Farm Management Section of Saskatchewan Agriculture. The assistance of many resource people and reviewers is gratefully acknowledged. We also gratefully acknowledge the review done by Deloitte, Haskins and Sells.

Farm Management Section
Economics Branch
Saskatchewan Agriculture
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I. Managing Income Tax

1. Getting the Most After Tax Income

Tax planning is concerned with using tax laws and management techniques to maximize after tax net income, not just to minimize the income tax paid. The following example indicates what after tax net income is:

Gross Farm Income	$90,000
Less: Cash Operating Expenses	40,000
Less: Capital Cost Allowance	20,000
Equals: Before Tax Net Income	$30,000
Less: Personal Exemptions	9,000
Equals: Taxable Income	$21,000
Income Tax Payable	6,154
Before Tax Net Income	$30,000
Less: Income Tax Payable	6,154
Equals: After-Tax Net Income	$23,846

Decisions made to minimize income taxes only, do not always result in the most after tax income. For example, a farmer may pay less income tax if he buys a new tractor, however, he may have fewer dollars in his pocket in the long run. Decisions to purchase major capital assets should be made after consideration is given to the long term implications. Income tax should be thought of in the same way as any business expense.

Effective tax planning focuses on three areas: deferral of tax, averaging of income, saving of tax.

Deferral of tax is concerned with the time at which income is received and expenses are paid. Tax deferral techniques include the use of deferred cash tickets, delaying the sale of farm production to a later tax period, purchasing farm inputs to reduce net income, purchasing registered retirement saving plans and rollovers. Tax deferral is useful if the costs of deferral are less than the benefits from deferral. A budget can be used to determine if deferring tax is beneficial.

Averaging income is an important tax planning strategy. Farm incomes tend to rise and fall from year to year. Our tax system levies progressively higher taxes on higher levels of income. By averaging income from high income years with that of low income years, total taxes are reduced. Methods of averaging income include the five year block average, livestock inventory provision, reserves, forward averaging and adjustments to income within a year by the timing of input purchases and product sales.

The saving of tax results in a lower amount of income tax being paid. It is a matter of being familiar with the tax system and utilizing the tax rules to your advantage. Examples of tax savings techniques are accurate, up-to-date records to ensure that all legitimate expenses are accounted for, splitting income between husband and wife and/or children, and the use of all tax provisions.

Tax planning must be an ongoing, year round activity. It requires good financial records, a knowledge of the tax system and careful financial planning to be effective.

2. Tax Rates, Tax Brackets and Indexing

Canadian income tax rates are based on a "progressive" tax system. In other words, a high income is taxed at a higher percentage than a low income.

A tax bracket is the range of taxable income for which the same rate of tax applies. The tax brackets apply only to the "marginal" tax rate, the tax rate that applies to an additional dollar of income. The "average" tax rate is the total tax payable as a percentage of the taxable income. It increases steadily, not in brackets.

The following example clarifies the difference between the marginal and average tax rates.

Example:

	No. 1	**No. 2**
Net Income	$29,000	$30,000
Less: Personal Exemptions	9,000	9,000
Equals: Taxable Income	$20,000	$21,000
Income Tax Payable	5,706	6,064
Income Tax Rates: Marginal	35.86	35.86
Income Tax Rates: Average	28.5%	28.9%

In this example, the marginal rate of 35.86% applies to all taxable income between $18,275 and $23,496. An extra dollar of income in Example No. 2 is taxed at the same marginal rate but results in a higher average tax rate because there is more income taxed at the marginal rate of 35.86%.

Table 1 and Figure 1 indicate the marginal and average tax rates for 1986. The calculations include the applicable federal and provincial rates, reductions and surtaxes.

Table 1
1986 Combined Federal and Saskatchewan Rates

Taxable Income	Tax	On Next
0 - 1,305	0 + 6.00%	
1,305	79 + 16.32%	1,305
2,611	292 + 17.30%	954
3,566	457 + 29.63%	1,654
5,221	947 + 31.26%	2,610
7,832	1,763 + 32.95%	4,249
12,082	3,163 + 29.78%	971
13,054	3,453 + 31.30%	5,220
18,275	5,087 + 35.86%	5,220
23,496	6,959 + 38.88%	6,245
29,742	9,387 + 40.15%	5,236
34,979	11,489 + 41.78%	1,570
36,550	12,145 + 49.87%	24,326
60,877	24,276 + 51.43%	1,779
62,657	25,191 + 58.07%	Excess

Figure 1 can be used to estimate the income tax payable for any level of taxable income. For example, at $40,000 taxable income, the average tax rate is approximately 34.7%. The tax would be approximately 34.7% x $40,000 = $13,880. An additional dollar of taxable income would result in about 49.9 cents additional income tax because the marginal rate is 49.9%.

Figure 1
Income Tax Rates — 1986

Total income tax payable is a function of federal and provincial tax rates. The federal tax rates remain the same each year, however, the tax brackets are indexed each year to account for inflation. The 1986 Saskatchewan rate is 50% of the basic federal tax calculation. The province has a basic tax reduction for lower income brackets. As well, there is surtax on higher incomes and a flat tax of 1% on net income. Federally, there is a surtax on the basic federal tax payable.

The annual indexing of tax brackets referred to above is also applied to the personal exemption levels each year. The indexing factor represents the change in the cost of living based on the Consumer Price Index (CPI). However, effective January 1, 1986, indexing will only occur when the CPI exceeds three percent.

In effect, if your taxable income increases each year at the same rate as the indexing factor, you will pay more total tax but the marginal rate on your last dollar of income will be the same.

Example:

Assume - Net income increases 10%
- Tax brackets and personal exemptions indexed upward by 10%

Effect:

	Year 1	Year 2
Net Income	$30,000	$33,000
Personal Exemptions	7,000	7,700
Taxable Income	$23,000	$25,300
Tax Payable	6,781	7,660
Marginal Tax Rate	35.86%	38.88%

If your taxable income remains the same from year to year, you will pay less tax and may drop into a lower marginal tax bracket.

Indexing is important in using the averaging and deferral provisions to your advantage. See Section VI for a discussion of these provisions.

3. Regular Tax vs Alternative Minimum Tax (AMT)

As suggested earlier the Canadian income tax rates are based on a "progressive" tax system. Therefore, a high income is taxed at a higher percentage than a lower income. Because of this tax system, there is an incentive for taxpayers to try and get their taxable income lower through various tax shelters. To assure that all tax payers pay a minimum amount of tax, the alternative minimum tax was introduced to take effect January 1, 1986.

The AMT proposed by the Federal Government essentially involves the recalculation of an individual's income for tax purposes. What it means is any one with a net income over $40,000 per year, will have to do two tax calculations. The recalculation adds back to income certain deductions or exemptions that are otherwise deductible for regular income tax purposes and receive preferential treatment. These tax preference items are added back to net income and to determine the base for the AMT calculation. The AMT tax calculation is allowed a $40,000 exemption.

The recalculated AMT taxable income is subject to a flat 17% minimum federal tax rate (25.5% including provincial portion). The tax payer is then required to compare the AMT calculation with his regular tax calculation and if the AMT is higher than the regular tax calculation then he is required to pay the additional amount. The proposal also allows for any minimum tax paid to be refunded in any of the following seven years, should the AMT calculation be lower then the regular tax.

For an individual who's net income exceeds $40,000, the AMT may affect them depending upon the makeup of their income and deductions. Any tax preference items, such as Canadian exploration expense, capital gains, RRSP, losses on MURBs, etc. will come into play when calculating the AMT.

The following tables will further illustrate the effect of AMT

Net Income Calculation:

Earned Income	$40,000
Grossed Up Dividends ($10,000 dividend paid)	15,000
Taxable Capital Gain (1/2 of $60,000)	30,000
MURB Rental Losses	(20,000)
RRSP Contribution	(5,500)
CDE* and CEE* on Resource Properties	(10,500)
Net Income	$49,000

* CDE (cumulative development expense)
* CEE (cumulative exploration expense)

Tax Calculation*

	Regular Tax	AMT
Net Income	$49,000	$49,000
MURB	-	20,000
Capital Grains Exemption	(30,000)	-
RRSP	-	5,500
CDE,CEE on resource properties	-	10,500
Personal Deduction	(9,000)	(9,000)
Investment Income Deduction	(1,000)	-
Deduct Gross up on Dividends	-	(5,000)
AMT exemption	-	(40,000)
Taxable Income	$9,000	$31,000
Tax	$ 300(A)	$8,488(B)
Tax Payable (the greater of A or B)		$8,488
Cost of minimum tax		$8,188

* Tax calculation based on 1986 rates.

II. How the Tax Department Defines "Farmer"

Farmers may use the cash method of accounting (see Section III), the five-year block average (Section VI) and other special tax provisions. A person with income sources other than farming, may be prevented from using tax provisions designed for farmers.

1. Types of Farming

The Income Tax Act defines farming as the tillage of the soil, livestock raising or exhibiting, maintaining of horses for racing, raising poultry, fur farming, dairy farming, fruit growing, and the keeping of bees. It also includes tree farming and the operation of wild game reserves. In some circumstances farming includes raising fish, market gardening, the operation of nurseries and greenhouses, and the operation of a chick hatchery. Farming does not include trapping or an office or employment under a person engaged in the business of farming.

Presumably any one who carries on any of the above activities as a business, is a "farmer". This broad definition of farmer would permit farms to be used as tax shelters where farming losses (including some living expenses) are applied to reduce other income. Consequently, three different types* of farmers are defined:

* The types referred to are given the labels hobby, part time and bonafide for convenience. These labels are not used in the Income Tax Act.

(i) Hobby farmers - who have no realistic expectation of profit from their farming operations.

(ii) Part-time farmers - whose farm can be expected to be profitable but whose chief source of income is neither farming nor farming plus some other income source.

(iii) Bonafide farmers - whose chief source of income is either farming or farming with some other subordinate income source.

Some factors used to classify farms into the above categories are:

(i) Income levels from farming and other income sources;
(ii) Future potential for farm profit;
(iii) Intention of the operator;
(iv) Time the operator spends farming; and
(v) Size of the farming business.

Success or failure does not determine whether an enterprise is a business. Nor does the phrase "farming combined with some other source of income" limit the other source to being related in any way to farming. Revenue Canada has very broad powers to judge whether or not a taxpayer is a farmer. However, Revenue Canada's initial decisions can be appealed through the court system which will ultimately decide the degree of business activity.

2. Treatment of Farming Losses

Hobby farmers have no expectation of profit. Consequently their farming expenses are considered to be personal and living expenses. Their farming losses are not deductible against other income.

Part time farmers can deduct farm losses up to $5,000 per year, calculated as follows:

(i) The first $2,500 is deductible;
(ii) Half of the next $5,000 is deductible; and
(iii) None of the remainder is deductible.

For example, if during the year a part-time farmer incurs a $6,000 farm loss, he could deduct $2,500 plus 1/2 of $3,500, or $4,250 from other income in that year. The remainder, $1,750 is called a "restricted farm loss". Beginning in 1983, a restricted farm loss may be deducted against net income from farming earned in the three years preceding and the ten years following the year of loss. Prior to 1983, restricted farm losses could be carried back one year and forward five years.

Bonafide farmers may deduct all farming losses from other income. Beginning in 1983, farm losses in excess of other income in the year of loss may be deducted against income earned in the three years preceding and the ten years following the year of loss. In addition, a farmer will be able to decide on what portion of a farm loss to apply in any particular year. Together with personal exemptions, farm losses can be used to reduce taxable income to a level where no income tax is payable.

For all other non-capital losses, the losses may be carried back three years and forward seven years.

Prior to 1983, farm losses could be carried back one year and forward five years.

3. Feedlot Operators

If you operate a feedlot you may not be considered a "farmer" for tax purposes. A feedlot operation qualifies as a farmer if most of the animals are fed for at least three months until they attain market weight, and if most of the animals are owned by the operator. Whether or not the feedlot operator grows his own feed is not a determining factor. Therefore, a feedlot can be located on a small acreage and qualify as a farm.

III. Farm Records — The Key to Effective Tax Management

1. What Records Do You Need?

Farm records are required for three reasons. First, records provide the basic information for filing income tax returns. Secondly, Revenue Canada requires that farmers keep adequate records that are available for inspection by Revenue Canada officials if so requested. Thirdly, up-to-date records will indicate the financial position of the farm before the end of the year, making income tax planning more effective.

The minimum record-keeping requirements for income tax purposes include the following:

(a) Income;
(b) Expenses;
(c) Capital sales and capital purchases; and
(d) Duplicate deposit slips, bank statements and cancelled cheques.

The following additional items assist in income tax filing and management:

(a) The date of purchase and cost of capital assets for capital assets for capital gains purposes;
(b) The fair market value of capital assets on December 31, 1971, if applicable, for capital gains purposes;
(c) Livestock inventories if the optional inclusion of value of livestock on hand or basic herd option of the Income Tax Act is used;
(d) Records of borrowing and principal payments; and
(e) Personal items that affect income tax filing, such as: charitable contributions, registered retirement savings plans contributions, medical and hospital expenses, pension benefits and interest, and dividend income.

Regular entries into the accounting system will improve accuracy. It will reduce the possibility of paying extra, unnecessary income tax and assist in avoiding unnecessary interest and penalties levied by Revenue Canada.

A $10.00 receipt which is lost and not entered into the accounting system has the effect of increasing taxable income by $10.00. For individuals in a 40% marginal income tax bracket, it costs an additional $4.00 income tax.

Penalties and interest may be levied if income is not reported. Tax penalties and interest are not deductible expenses for income tax purposes.

Unincorporated farms are required to make an installment payment of income taxes by December 31 of each year if federal tax payable is over $1,000.00. The installment should be two-thirds of either the previous year's income tax payable or the estimated income tax payable in the current year. Interest is charged on late instalment payments if such interest exceeds $25.00.

2. Good Accounting Practices

Good business and accounting practices should back up the accounting system used. This would include the following:

(i) Filing Systems

All supporting documents, such as receipts, bills, invoices and cheques, should be filed as proof of entries into the accounting system. They should be filed in a manner which will allow ready retrieval if required.

It is a requirement of the Income Tax Act that business records and all supporting documents necessary to verify the information contained therein must be kept. Effective September 20, 1982, records and vouchers must be kept for six years after the end of the year to which the records pertain. If a tax return is filed late the records and vouchers must be kept for six years after the date of filing the return.

It is advisable to retain records of capital purchases (land, buildings, machinery) for as long as these assets are owned, or for a minimum of six years. Business records must be in such a form and contain the information necessary to determine income tax payable.

(ii) Banking

The bank account is an important part of the accounting system. You can check the account book with the bank balance. It provides further backup to supporting documents on file and will assist in making entries into the accounting system.

It is desirable to deposit all income into the bank account. A deposit book should be used and a duplicate copy of each deposit kept on file. Income entries in the accounting system should cross reference with deposits to the bank account.

Farmers should maximize the use of cheques to pay expenses and minimize the use of cash. Receipts should always be obtained for all expenses even if paid by cheque. Cash register receipts such as those obtained from retail stores are often not adequate as proof of purchase. In such cases, a written receipt should be obtained.

Farmers should keep separate farm business and personal bank accounts. The farm business account is used for deposits of farm and related income, and for withdrawals of farm and related expenditures. Periodically an amount can be transferred to the personal account from which all personal transactions are made. In this manner, farm records and the farm business bank account can be more easily reconciled.

(iii) Farm Office

Business procedures are improved if a separate room with a desk is available as an office. This reduces the possibility of business records becoming lost or mixed with other papers. Supporting documents may be left there until they are ready for entry into the accounting system.

3. Accounting Systems

A wide range of accounting systems are available through the Saskatchewan Department of Agriculture, chartered banks, chartered accountants and agribusiness firms. Some systems can be used for both income tax and farm management purposes, others for income tax only. Some of the bank systems use cancelled cheques as an information base. Some systems are manual and others computerized.

See your Agricultural Representative or Farm Management Specialist for further information on farm accounting systems and assistance in starting up a system suited to your needs.

4. Cash or Accrual Accounting

Individuals, corporations, partnerships, and trusts in the business of farming may use either the "cash" method or the "accrual" method of accounting for income tax purposes.

The vast majority of farmers use the cash method. It provides the most flexibility for reporting income. Farmers may determine the most opportune time to receive income and pay expenses. The cash method requires simpler farm records than the accrual method.

(i) Cash Method - Income is reported in the year it is received and expenses are deducted only in the year in which they are paid. For example, if a farmer charges his 1985 fertilizer purchase and pays it in cash in 1986, it would be an expense for the 1986 taxation year.

(ii) Accrual Method - Income is reported in the year it is earned regardless of when payment is received. Expenses are deducted in the year in which they are incurred, whether paid or not. Income is adjusted by including changes in the values of livestock, grain, feed, fertilizer and other farm inventories. A balance sheet must be filed with the income tax return.

5. Calendar or Fiscal Year Reporting

Some farm businesses may find it useful to report income according to a chosen fiscal year (e.g., July 1 to June 30) rather than on a calendar year basis (January 1 to December 31). If a large portion of the annual income is received in one part of the year, beginning the fiscal year just prior to the receipt of that income may delay the payment of income tax longer. Revenue Canada must grant permission before a change in a fiscal year can be made. However, beginning farmers may start out using any fiscal year.

6. How to Get the Most From Your Accountant

(i) Can Farmers File Their Own Income Tax Returns?

Many farmers who file their own returns should keep abreast of income tax changes that affect their business. This can be done by reading income tax articles in newspapers, magazines, periodicals, and extension bulletins, by studying the Farmer's Income Tax Guide and by reading the Tax Guide which is mailed along with the annual Income Tax Return.

(ii) Selecting an Accountant

For farmers who hire an accountant for income tax services, there are two general types of accountants. These are:

Chartered Accountants - Individuals who have been formally trained in accounting, usually at a university. They belong to a professional organization with established minimum standards of practice.

General Accountants - Training and experience will vary with the individual. Included are income tax filing firms, income tax consultants, lawyers and others.

Fees are normally charged on an hourly basis. The range of fees depends on the reputation, skill, and knowledge of the individual.

Select an accountant with an office in the district, town, or city in which normal farm business is conducted. The accountant should be familiar with farm businesses and have a good reputation with his farm clients. Often, just asking neighbors will put a farmer in contact with a good accountant.

Large complex farm businesses may require the services of larger firms with specialized consultants. Such firms are usually located in larger towns and cities.

(iii) Prepare Before You See the Accountant

Although familiar with relevant tax laws, the accountant knows little about the individual's farm business. Therefore it is important to organize all the relevant information in a systematic manner before going to the accountant. Have all income expenses and capital transactions recorded into an accounting system. Add up the totals for each category. Write out the income, expenses and capital transaction items that you do not know how to handle, and discuss these with the accountant.

The following may serve as a guideline for information to supply to your accountant:

- Income and expense records, receipts and invoices;
- Previous five years' income tax returns;
- List of medical expenses and charitable donations and receipts;
- Other deductions;
- All T4 and T5 slips and Family Allowance Information Slip;
- Income tax installments made;
- Contributions to registered retirement savings plans;
- Invoices of capital transactions (purchases and sales);
- Income earned by spouse and children.

(iv) When to See Your Accountant

Accountants are busiest during the months of March and April. The service may be speedier and perhaps cheaper if the tax return can be prepared as soon as possible after January 1. The return may be prepared early, but held until near the end of April in order to delay the payment of income tax as long as possible.

To avoid having your accountant fill out forms twice, be sure that all employment and investment information slips (T4 and T5, etc.) are in before he does the work.

When seeking advice on detailed tax planning, business organization (partnerships, corporations, etc.) or major business decisions see the accountant in the months of May to December.

IV. What You Should Know About Capital Gains and Losses

1. What is Capital Gain?

In its simplest form a capital gain is an increase in the value of an asset from the time you buy it to the time you sell it. Therefore, the formula to determine a capital gain is:

Capital Gain = Proceeds of Sale - Purchase Price

Beginning in 1972, capital gains have been subject to taxation when assets are sold, gifted, willed or otherwise transferred. However, beginning in 1985 all taxpayers are eligible for a lifetime capital gain exemption of $500,000.

Practically any asset, other than a "principal residence" may be subject to taxation of capital gains. For farm people, the major consideration is farm land. As well, farm machinery and buildings may be sold for more than their original price, giving rise to a capital gain. Capital gains may also arise on ownership interests in a farm partnership, shares in a farm corporation, investments such as stocks or bonds, and any "personal use property" worth more than $1,000, such as antique cars, jewellery or works of art.

Capital gains are not taxed at a flat rate. Rather, one-half of a capital gain is added to the seller's taxable income and is subject to tax at that rate determined by his income from all sources for the year.

Let us examine some examples of capital gains:

	Land	Combine	Shares	Diamond Ring
Sale Price	$55,000	$32,000	$1,350	$1,100**
Purchase Price	15,000	30,000	1,050	1,000
Capital Gain	40,000	2,000	300	100
Taxable Portion of Capital Gain* (1/2)	$20,000	$ 1,000	$ 150	$ 50

* The taxable capital gain in this example is eligible for the capital gains exemption.

** A diamond ring is "personal use property" asset, and is always assumed to have a purchase price of at least $1,000, even if the actual purchase price was less.

The original purchase price is known as the "adjusted cost base" (ACB) of the asset.

Adjustments are made to it when part of the asset is sold or when expenses are incurred in buying, maintaining or improving the asset but are not deductible from income at the time the expense was incurred.

When calculating a capital gain the expenses of selling the asset can be deducted from the sale price. The deduction is for "outlays and expenses" such as survey and subdivision costs, legal expenses, land registration fees, and commissions to real estate agents, auctioneers or investment dealers.

In certain situations, such as when assets are gifted or passed on by will, the sale price is assumed or "deemed" at a certain level, rather than being the actual price.

2. What is a Capital Loss?

A capital loss occurs when an asset is sold for less than its adjusted cost base.

In 1985, a new capital gains exemption (see Section 3) was introduced. To be consistent with the new system, ordinary capital losses that are realized will no longer be deductible against up to $2,000 of other income. The loss will generally be applied against your lifetime capital gains exemption. Therefore, a $2,000 taxable capital loss would be carried forward to apply against any future capital gain.

There is, however, an allowable business investment loss which continues to be deductible. For example, one-half of the losses incurred on shares or debt of a Canadian small business corporation remain deductible as an allowable business investment loss.

However, the amount claimed as a loss must be brought back into income before any future capital gain exemption can apply.

A capital loss cannot be claimed on a "depreciable" asset, that is, one which is entered on your "capital cost allowance schedule" (see Section V), nor on any "personal use property".

3. Cumulative Lifetime Capital Gains Tax Exemption.

The May 23, 1985 federal budget introduced a lifetime capital gains exemption of $500,000 ($250,000 taxable capital gain). This exemption will apply to capital gains realized by an individual on all capital property. Corporations and trusts do not qualify for this exemption.

The exemption will apply on all capital property. Property includes farm land, buildings, machinery, corporate shares, partnership interest, etc. Your principal residence will continue to be exempt from capital gains and will not reduce an individual's lifetime capital gains exemption. A gain on the disposition of a quota and the cash bonus on a Canada Savings Bond will not qualify for the exemption. These are not a true capital gain and thus are not eligible.

This measure will be phased in over six years. The exemption will have a cumulative limit of:

$20,000 of capital gain ($10,000 taxable) in 1985;
$50,000 of capital gain ($25,000 taxable) in 1986;
$100,000 of capital gain ($50,000 taxable) in 1987;
$200,000 of capital gain ($100,000 taxable) in 1988;
$300,000 of capital gain ($150,000 taxable) in 1989; and
$500,000 of capital gain ($250,000 taxable) in 1990.

The phase-in measure will not apply to qualified farm property. This property will qualify for the immediate exemption of $500,000. Qualified farm property includes:

(1) Farm land and farm buildings currently being used in the farm business by the taxpayer, their spouse or child;

(2) Shares in farm corporation and interest in a farming partnership if taxpayer, their spouse or child are actively engaged;

(3) Farm land and buildings used in the farm business by a taxpayer, their spouse or child for at least five years.

It should be noted that the capital gains triggered on a land sale is subject to the minimum tax. Sales where the capital gain exceeds $90,000 would be effected by the minimum tax calculation. If, for example, you had a land sale where the taxable capital gain was $200,000 the tax calculation would be as follows:

Farm Income	**Regular Tax**	**AMT**
Farm Income	7,000	7,000
Taxable Capital Gain	200,000	200,000
Capital Gains Exemption	(200,000)	-
Personal Exemptions	(7,000)	(7,000)
AMT Basic Exemption	-	(40,000)
Taxable Income	Nil	160,000
Taxes	Nil	40,800

4. Special Considerations for Assets Owned Before 1972

Taxation of capital gains began on January 1, 1972. To avoid taxing the gain which came about before this date, the December 31, 1971 (valuation day or V-day) value can be used as the adjusted cost base for assets owned before 1972.

There are two alternative methods for calculating capital gains on assets owned before 1972, the median rule method and the valuation day method. If one of these methods has been used, it must always be used.

(i) Median Rule Method

The median rule or "tax-free zone" method is usually used to calculate capital gains and losses on assets owned on V-day. This method takes into account three values for each asset; the original price, the V-day value, and the sale price. The middle amount of these three values is considered to be the adjusted cost base. If two amounts are equal in value, that value becomes the adjusted cost base. As with assets bought since V-day, the gain or loss is the difference between the sale price and the adjusted cost base.

The following examples will illustrate the median rule method:

Example:

	Building Lot	Farm Land	Shares	Tractor
1969 - Bought Asset	$10,000	$25,000*	$1,000*	$8,000*
1971 - V-Day Value	12,000*	22,000	1,500	7,000
1985 - Sold Asset (A)	25,000	42,000	900	8,000
Minus Middle Value (B)*	12,000	25,000	1,000	8,000
Equals Capital Gain(+)/Loss(-) (A-B)	+13,000	+17,000	-100	nil

(ii) Valuation Day Method

The valuation day method takes into account only the sale price and the V-day value to calculate the capital gain.

Example:

	Building Lot	Farm Land	Shares	Tractor
1985 - Sold asset (A)	$25,000	$42,000	$ 900	The Valuation Day Method applies only to non-depreciable property.
Minus 1971 V-day value (B)	12,000	22,000	1,500	
Equals Capital				
Equals Capital Gain(+)/Loss(-) (A-B)	+13,000	+20,000	-600	

(iii) Which Method Should You Use?

Table 2 indicates the capital gain and loss implications of various circumstances. Read across the table to see the results of using each method to calculate capital gains or losses with a given sequence of value changes.

Table 2
Comparison of Median Rule and Valuation Day Methods

Original Cost	V-day Value	Sale Price	Capital Gain (+)/Loss (-)	
			Median Rule	V-day
$1,000	$2,000	$3,000	+$1,000	+$1,000
3,000	2,000	1,000	-1,000	-1,000
1,000	3,000	2,000	0	-1,000
3,000	1,000	2,000	0	+1,000
2,000	1,000	3,000	+1,000	+2,000
2,000	3,000	1,000	-1,000	-2,000

This table indicates the median rule and valuation day methods are equal if the V-day value is between the original cost and sale price. The valuation day method is of advantage only if the V-day value is higher than both the original cost and sale price. The median rule is best when the V-day value is lower than both the original and sale prices.

Most farmers in Saskatchewan should use the median rule method. They will likely benefit from this method if they purchased land in the high price period of 1967 to 1970.

5. Valuation Day Values

Farmers who do not presently have records describing the condition and value of their farms and other assets as of December 31, 1971, should record this information now. When assets owned before 1972 are gifted or willed, the V-day fair market value must be determined.

"Fair market value" is the price of an asset when it is sold by a willing and informed seller to a willing and informed buyer, who have no motive other than the sale of an asset.

It may be difficult now to remember the condition of the farm, the values and condition of the improvements (buildings, fences, dugouts) on it, and other price-determining factors, but it will become more difficult as the time goes on. This information will be useful in assessing the tax position of a farmer considering selling out, and is very valuable to the executor(s) of an estate. Unnecessary tax dollars and appraisal fees will be saved.

A list of "comparable sales" of farms sold in 1971 and 1972 are available for each rural municipality. It can be obtained from Revenue Canada District offices in Saskatoon and Regina, or from Saskatchewan Agriculture farm management specialists. This information is valuable for establishing the V-day value of a particular farm. However, to back up the V-day value arrived at, record the following about both the property being evaluated and comparable property:

(i) Land location, distance to all-weather roads;
(ii) Description of land - acres cultivated, wasteland, pasture, etc.;
(iii) Type of farming - crop, pasture, rotation;
(iv) Soil type, hilliness, stoniness, drainage, subject to flooding or not;
(v) Condition of land - well farmed, weedy, rundown;
(vi) Age, size, condition and value of buildings and other improvements;
(vii) Municipal assessment as of 1971.

Pictures are very useful to record differences or similarities among properties, as well as the condition of buildings.

Be careful not to compare properties only on the basis of their values for municipal assessment. Improvements could have been made to either the subject or the comparison property before 1971 and the 1971 assessment might not reflect these.

Also consider the conditions of sale of the comparable parcel. If it was sold to a child or if health or debt problems forced the sale, the sale price might not reflect the true fair market value at V-day.

For other assets, make a list of the assets with their condition, 1971 value, and information about the sale prices of similar items sold in 1971. The V-day values of publicly traded shares are available from Revenue Canada (V-day for these was December 22, 1971).

6. Principal Residence

Your principal residence must be ordinarily inhabited in the year by the taxpayer. You can have only one principal residence at a time. The capital gain on a "principal residence" is not taxable. However, if capital cost allowance is declared on a portion of the farm house, a capital gain on that portion is subject to taxation.

Two alternatives are available to calculate the portion of exempt capital gain respecting a farm principal residence. One alternative must be selected at the time of sale.

(i) The farm can be sold separate from the house and up to one acre (1/2 hectare) of land, and capital gain declared only on the land and improvements. The capital gain on the house and up to one acre of land is not subject to taxation.

(ii) The entire property can be sold as a unit, including the house. An amount is then deducted from the total capital gain (before calculating the taxable portion), equal to an initial $1,000 plus a further $1,000 for each year since 1971 (or since the year of purchase, if purchased after 1971), that the house was the farmer's principal residence.

Example: A farm, with the principal residence of the farmer, is sold in 1985 for $140,000. ($112,000 for land; $28,000 for house). The unit was purchased before 1972. The adjusted cost base is $48,000 for the land and $8,000 for the house.

The farmer has declared capital cost allowance on the one-quarter "business" portion of his house and must include any capital gain on this portion.

The following illustrates the effect of the two options for calculating the deduction from capital gain for the principal residence:

(i) The house plus a parcel of land is excluded from the farm sale:

	Sale Price	Adjusted Cost Base	Capital Gain
Land	$111,300	$47,700	$63,600
Residence (25% business portion)	$ 7,000	$ 2,000	$ 5,000
Total Capital Gain			$68,600

(ii) The residence is included in the sale of the farm:

	Sale Price	Adjusted Cost Base	Capital Gain
Land plus house	$140,000	$56,000	$84,000
Less Principal Residence Deduction ($1,000 + 14 x $1,000)			$15,000
Total Capital Gain			$69,000

After 1981, only one principal residence exemption will be permitted in a family. Prior to this it was possible for a husband and wife to each have a principal residence (e.g. main home and a cottage).

Any family which had two principal residences on December 31, 1981 will be permitted to have only one after December 31, 1981. The family can decide at the time when one of the properties is sold which should be the principal residence. Any capital gain realized on the second residence up to December 31 1981 will be free of capital gain tax while any gain after that date will be subject to tax. This means that families with two principal residences on December 31, 1981 should value the property as of December 31, 1981. In fact, both properties should be valued on that date, since the family can decide at some later date to which of the two properties the principal residence exemption should be applied.

7. Sale of Part of the Property

If a lot or right-of-way is sold, the capital gain or loss must be calculated by using a reasonable portion of the adjusted cost base of the whole property. For example, if a 16 acre parcel is sold out of a 160 acre quarter section worth $11,000 in 1971, the adjusted cost base of the parcel would be one-tenth of that of the quarter section or $1,100. The portion of the adjusted cost base used for the partial sale is subtracted from the adjusted cost base of the remaining property.

When compensation is received for damages to property which is not repaired or money is received for an easement or right-of-way on property, the taxpayer may fully offset the proceeds received by using a portion of the total adjusted cost base that is equal to the proceeds received. In effect capital gain can be fully offset at that time. The amount of property damaged or taken for a right of way or an easement must be small, that is 20% or less in relation to the total property.

When the remainder of the property is disposed of, the adjusted cost base of the total property must be reduced by the amount used to offset the compensation received for the partial disposition.

8. Family Land Transfers

When related people do business with one another, they are said to deal at "non-arm's length" and must sell to one another only at current fair market value. "Related" refers to people who are related by "blood, marriage, or adoption." Brothers, sisters, parents, children, grandchildren, great grandchildren, grandparents, in-laws, and adopted or wholly dependent children are considered to be related for tax purposes. Aunts, uncles, nephews, nieces and cousins are not. However, if a taxpayer deals with any person like a relative, not as a stranger, he may be dealing with them at non-arm's length and subject to the same restrictions. As well, a person does not deal at arm's length with a corporation owned by him or by a group of which he is a member or to which he is related.

If land is transferred at non-arm's length for less than current fair market value, Revenue Canada will assume that the transfer took place at fair market value and one-half of the capital gain will be taxable. Certain exceptions are made to this rule, notably certain parent to child and spouse to spouse transfers (see "Tax-deferred Rollover" below).

A price adjustment clause can be included in a sales agreement when the parties to a non-arm's length transfer wish to ensure that the price is at fair market value. This clause states that if Revenue Canada determines the fair market value to be other than that agreed upon, the price will be adjusted to account for the excess or shortfall. In the year of sale, each party would include with his tax return a letter advising Revenue Canada that he is prepared to have the price reviewed. If a different value is determined, Revenue Canada will adjust the tax form and the parties will account for the change in price.

9. Rollovers

The capital gain rollover provision still applies even though the capital gain exemption was introduced. In these situations, property can be transferred between family members without incurring an immediate capital gain. This is called a rollover. The transfer of the property takes place at a price which creates no capital gain for the transferor and leaves the new owner in the same tax position as the transferor. The capital gain is not avoided but is deferred. All transfers between spouses and some transfers of farming assets to children can qualify for rollovers.

Rollovers Between Spouses

In a spouse to spouse transfer of any asset, no capital gain will arise if the property is gifted or willed or the spouse receiving the property does not pay a price that is more than the asset's adjusted cost base. The other conditions necessary to qualify for the rollover are:

(i) Both spouses must be residents of Canada;

(ii) The property must be capital property located in Canada;

(iii) In the case of a transfer at death, the property must vest indefeasibly in the surviving spouse within 36 months of the death.

(iv) If property is transferred to a spouse trust, the surviving spouse must be entitled to all the income arising from the property during her life and no other person is entitled to receive or use any income or capital of the trust.

In a rollover of farm land to a spouse, it is not necessary that the land be used in the business of farming by someone in the family as is the case when farm land is transferred to a child.

The attribution rule may apply in that future income may be taxed in the hands of the spouse who makes the original transfer. This means that rental income and capital gain if the property is sold would be taxable in the hands of the spouse who transferred the property. (See Section VII under "Family")

A taxpayer can elect to transfer property to a spouse at fair market value, thereby giving rise to a capital gain or loss. This election may be beneficial if there are accumulated losses that can be offset with the taxable capital gain on the property transferred. It would also enable you to use your capital gain exemption and pass any further capital gain on to your spouse.

Rollovers to Children

Canadian farm property, depreciable assets under the Part XI (diminishing balance) method of capital cost allowance (see Section V), ownership interest in a family farm corporation or family farm holding corporation can be rolled over to children without capital gains tax arising immediately. In this section we deal strictly with farm land. The following rules apply:

(i) Children include grandchildren, great grandchildren, daughters-in-law, sons-in-law, illegitimate children, legally adopted children, stepchildren and foster children. For transfers after 1983 the definition of child also includes a person who, before age 21, was wholly dependent upon and under the custody and control of the taxpayer. An example of this would be where a farmer, after the death of his brother and brother's wife, takes custody of a nephew. The nephew will qualify as a child.

(ii) The farm land must be used in the business of farming by the taxpayer, his spouse or any of his children immediately before the transfer takes place. It is not necessary for an individual to do all or even a major portion of the work on a farm to meet the "used in the business of farming" requirement.

Virtually all of the farm work could be hired on a custom basis providing the individual assumes a portion of the risk of the operation and provides management. (See Section VII, for a discussion of custom farming agreements.)

Land which is leased to anyone other than a spouse or a child, is not considered to be used in the business of farming. However, beginning with the 1984 taxation year, farm land leased by a taxpayer to his family farm corporation or to his spouse's or child's family farm corporation or partnership will qualify for a rollover.

(iii) It is not necessary for a child to use the land in the business of farming after the transfer takes place. In addition, the rollover can apply to more than one child. For example, if a taxpayer rents three quarter sections of land to his son John, the rollover would apply if he transferred one quarter to each of his three children, John, Bert and Bill, even though Bert and Bill are not farmers.

(iv) The child must be a resident of Canada.

(v) The rollover is permitted for transfers occuring during the taxpayer's lifetime, that is, by way of gift or sale. In the case of a sale, if the selling price is between the adjusted cost base and fair market value, the deemed proceeds are equal to the selling price and the capital gain is equal to the selling price less the adjusted cost base. This situation results in a partial rollover and a partial capital gain. If the selling price is greater than the fair market value and the adjusted cost base, the deemed proceeds are equal to the greater of the fair market value and the adjusted cost base. If the selling price is less than the adjusted cost base and the fair market value, the deemed proceeds are equal to the lesser of those two figures.

The following example illustrates this:

Example: A farmer is transferring farm land he owned before 1971 to his son. The land was worth $50,000 in 1971, and is valued at $120,000 when he transfers it. The following table indicates the capital gain and deferral implications of various prices:

Sale Price	Father's Deemed Proceeds	Father's Capital Gain*	Capital Gain Deferred	Son's Adjusted Cost Base
$ 1	$ 50,000	$ 0	$70,000	$ 50,000
25,000	50,000	0	70,000	50,000
50,000	50,000	0	70,000	50,000
100,000	100,000	50,000	20,000	100,000
120,000	120,000	70,000	0	120,000

* This portion is eligible for the capital gains exemption.

In the above example, it may be wise to transfer at market value and utilize your lifetime capital gains exemption. It also entitles the son to a higher adjusted cost base. The rollover provision could be used once you reach the maximum exemption of $500,000.

(vi) A rollover may occur on a transfer to a trust for a minor child. The trust is required because the law prevents a minor from owning property. The following conditions must be met:

(a) The trust is irrevocable;
(b) The property must be held in trust for the exclusive benefit of the child and there must be no provision which denies the child of his rights as an owner;
(c) The trust must provide for the distribution of the property to child when a specified age is attained or distribute the property to his estate if the child dies before the attained age.

(vii) A rollover may occur when land is transferred to a child subject to the retention of life interest in the land. This is referred to as an inter vivos life estate. The child becomes the owner of the property but the transferor is entitled to the income from it as long as he lives. The income could be in the form of a rental paid by the child to the transferor. There are several advantages to this arrangement:

- The child is assured of ownership of the land;
- The transferor is assured of income (rent) from the land while alive;
- The child may use the land as security to purchase other property;
- A capital gain rollover can occur; and
- The income or rent is taxable income to the transferor.

In order for a rollover to occur, it is necessary that both parties (transferor and child) agree in writing that there is a transfer of land to which subsection 73(3) of the Income Tax Act applies (rollover provision).

(viii) A rollover may occur on a transfer of land to a child on the death of taxpayer as directed by a will. On any transfer at death the property must vest indefeasibly in the child within 36 months of the death of the taxpayer. To vest indefeasibly means that a person acquires the right of absolute ownership to property and the rights of ownership cannot be defeated by any future event even though the person may not be entitled to the immediate enjoyment of all the rights of ownership.

A full explanation of this term is contained in Revenue Canada's Interpretation Bulletin #449 - "Meaning of Vested Indefeasibly."

In the case of a transfer at death, the rollover only occurs on a direct transfer to a beneficiary or through a spousal trust. A rollover is not permitted if the estate sells land even if the selling price is equal to the adjusted cost base.

Beginning with the 1984 taxation year, the representatives of a deceased taxpayer may elect to transfer property that otherwise qualifies for a rollover at any value between the adjusted cost base and fair market value. This will permit the estate to recognize some income on the transfer of property to offset losses that may not otherwise be utilized.

If a farmer is transferring more than one parcel of land to his child, he should consider how to allocate the total price to the various parcels. For example, a father wants to sell two quarter sections to his son for $40,000. The fair market value of each is $40,000 and the adjusted cost base of each is $20,000. If he gifts one quarter at $0 and sells the other for $40,000, he will have capital gains of $0 and $20,000, respectively. If he sells each for $20,000 he will receive the same total amount of $40,000 but incur no capital gain.

When rolling over a farm with a principal residence to a child, a farmer should set the sale price at the adjusted cost base plus the amount of the principal residence deduction. This will ensure that the principal residence deduction is not "lost" in the rollover.

(ix) Rollovers to Parents. A rollover is permitted of a family farm (farm property, interest in a family farm partnership, shares of a family farm corporation or small business corporation) from a child to a parent where the child obtained the property from a parent and where the property is transferred back to the parent upon the death of the child. This is effective where the child dies after 1983. This rollback to the parents can be at any value between the adjusted cost base and fair market value of the property.

Consult with a farm management specialist or an accountant when considering a rollover.

10. The Special R.R.S.P. Capital Gain Exemption

The $120,000 farm capital gain deferral through the use of an R.R.S.P. was repealed effective May 24, 1985. This provision was replaced by the $500,000 lifetime capital gains exemption. Contributions made prior to January 1, 1985 will remain in place and will not affect your lifetime capital gain exemption. However, contributions made in 1985 for sales between January 1 and May 24, 1985 will reduce an individual's lifetime capital gains exemption.

11. Property Exchanges

Expropriations
When land is expropriated and replaced, the capital gain can be rolled over to the replacement property. The taxpayer qualifies for a rollover if he buys a replacement property within two years from the end of the taxation year in which he agrees to the full compensation or the year in which the compensation level is decided in court. The rollover is handled in a

manner similar to that of voluntary property exchanges, as described below.

Voluntary Exchanges

Since April 1, 1977, farmers have been able to sell farm land and defer the capital gains if they purchase other farm land. This provision also applies to capital gain and recaptured capital cost allowance on buildings. Farmers can elect to use this provision when land is traded or a farm is relocated. The rules are as follows:

(i) The former property must be a business property immediately before its sale and also be real property used mainly to gain or produce income. A rental property does not qualify. A rollover may not be allowed if the property was recently converted from producing rental income to producing business income and it is evident that the owner has no real intention of continuing its use as a business property but did so only to qualify for the rollover.

(ii) The replacement property purchased must be put to the same or similar use as the former property. For example, farm land could not be replaced with a motel. However, crop land could be replaced with pasture land since both are types of farm land. Land can be replaced by buildings or visa versa as long as the replacement property is used in the same or similar business as the former property.

(iii) The replacement property must be purchased before the end of the taxation year following that in which the property was sold.

(iv) The replacement property may be purchased before the former property is sold. There is no time restriction for selling the former property, however, the taxpayer should be actively attempting to sell the former property after the replacement property is purchased. Once purchased a replacement property may not be sold prior to the sale of the former property.

(v) If a former property is sold and a replacement property is not purchased in the same taxation year, the capital gain on the former property must be declared on the Income Tax Return and income tax paid. If a replacement property is purchased the following year, the taxpayer can request a reassessment of the prior year's return in order to receive a refund of tax paid.

(vi) The taxpayer must file a written election with the Income Tax Return in order to apply the rollover. If the former property is sold and replacement property is purchased in the same year, then the calculation of recaptured capital cost allowance and capital gain on the return is sufficient for the election.

If the replacement property is purchased in the year following the year of sale of the former property, the election should take the form of a letter in the year the replacement property is purchased. The letter should describe the two properties, show the revised calculations and request a reassessment of the previous year's tax return.

If the replacement property is purchased in a year prior to the sale of the former property, the election should take the form of a letter attached to the tax return in the year the replacement is purchased. The letter should describe the replacement property as well as the former property which will be sold.

The amount of capital gain rolled over and the adjusted cost base of the replacement property depends on the cost of the replacement property. (see Table 3)

Table 3
Effect of Replacement Cost in Property Exchanges

Replacement Cost	**Capital Gain Rolled Over**	**Adjusted Cost Base of Replacement**
Less than or equal to adjusted cost base of former	None	Replacement Cost
Between adjusted cost base and sale price of former	Replacement cost minus adjusted cost base of former	Adjusted cost base of former
Greater than sale price of former	All	Adjusted cost base of former plus replacement cost minus sale of former

Some examples will illustrate the above. A farmer sells a quarter section for $20,000. He bought it for $10,000 in 1978. He purchases a replacement property. The following table indicates the tax implications of various costs of the replacement property.

Example:

Purchase Price of Replacement	Capital Gain Realized	Capital Gain Deferred	Adjusted Cost Base of Replacement
$25,000	$ 0	$10,000	$15,000
20,000	0	10,000	10,000
17,000	3,000	7,000	10,000
12,000	8,000	2,000	10,000
10,000	10,000	0	10,000
5,000	10,000	0	5,000

12. Sale of Buildings with Land

When land is sold with buildings, the value of each building should be itemized separately from the land in the sales agreement. These values are used to determine capital gain and recaptured capital cost allowance for the seller and form the basis for determining capital cost allowance for the buyer. (See Section V for Capital Cost Allowance considerations). Revenue Canada usually cross references values used by the seller and buyer to ensure that they are the same. Where buildings are not listed in the agreement, purchasers of property will often not claim capital cost allowance they are entitled to and vendors may include the value of Part XVIII buildings as part of the land proceeds resulting in the payment of additional income taxes.

Special rules now apply for buildings sold after November 12, 1981. These rules are designed to prevent the minimization of recaptured capital cost allowance or the creation of a terminal loss when a building is disposed of either by itself or when sold with land.

If a building and the land on which it is located are sold in the same year, then the value attributed to the building for taxation purposes must be the greater of the fair market value of the building at the time of its disposition or the undepreciated capital cost of the building, irrespective of the value indicated in the agreement for sale. For example, if the value placed on the building in the agreement for sale was $10,000, while the fair market value was $15,000, and the undepreciated capital cost was $12,000, the deemed proceeds of the building would be $15,000. The deemed proceeds could never be less than the building's undepreciated capital cost. The deemed proceeds are used to calculate capital cost allowance in the year of sale as well as capital gain on the building. This rule has the effect of increasing recaptured capital cost allowance or eliminating a terminal loss.

If the deemed proceeds are greater than the actual price of the building on the agreement for sale, the difference is deducted from the price of the land on the agreement for sale.

If a building is sold but the land is retained, the deemed proceeds are the original proceeds plus one-half of the difference between the undepreciated capital cost and the fair market value (whichever is greater) and the original proceeds. In the example noted above the deemed proceeds would be $12,500 ($10,000 + 1/2(15,000 - 10,000)).

13. Sale of Other Assets With Land

Machinery and livestock sold with land should also be fully itemized and valued in the sale agreement.

When a standing crop is sold with land, it is part of the land. The seller claims the expenses of planting the crop but does not report its income value.

However, if itemized in the sales agreement or swathed, its value is fully taxable income to the seller, and an expense to the buyer.

14. Adjustments for Land Clearing and Breaking

The costs of land clearing and breaking are handled as shown in Table 4 for capital gains purposes:

Table 4
Effect of Land Clearing and Breaking Expenses on Adjusted Cost Base

Date of Clearing and Breaking Expense	Deductibility as an Expense in that Year	Adjustments to Adjusted Cost Base (ACB) and Proceeds of Sale
Before 1965	Non-deductible	Add value to original cost but not V-day value when determining ACB. Do not subtract from proceeds of sale.
1965-1971	Deductible	Add value to original cost but not V-day value when determining ACB. Do not subtract from proceeds of sale.
After 1971	Deductible	If added to original cost or V-day value when determining ACB, also add it to proceeds of sale.

Example:

Land is bought in 1960 for $10,000. Clearing is done in 1962, 1967 and 1973 for cost of $2,000, $3,000 and $5,000, respectively. The V-day value is $20,000 and the land is sold for $40,000. The following shows calculation of the capital gain by the median rule method:

Determination of the adjusted cost base:

Original cost	$10,000
Plus clearing cost - 1962	2,000
- 1967	3,000
- 1973	5,000
Adjusted original cost	20,000
V-day value	20,000
Plus clearing costs - 1973	5,000
Adjusted V-day value	25,000
Proceeds of sale	40,000
Adjusted cost base (middle value)	25,000

Determination of capital gain:

Proceeds of sale	40,000
Plus deducted clearing costs deducted from income since 1971	5,000
Adjusted proceeds	45,000
Minus Adjusted Cost Base (middle value)	25,000
Equals capital gain	$20,000

15. Saskatchewan Capital Gains Tax Rebate Program

As a result of the introduction of the $500,000 capital gains exemption for federal and provincial income taxes, the following changes have been made to the Saskatchewan Capital Gains Tax Rebate Program.

1. Farmers who have disposed of farm property on or after January 1, 1985 are no longer eligible for the Saskatchewan Capital Gains Tax Rebate. However, they are eligible to claim the Rebate on dispositions between January 1, 1979 and December 31, 1984.

2. The Capital Gains Tax Rebate Program will continue to apply to business people who sell business property on or after January 1, 1985 and before January 1, 1987. However, the program will not apply to taxable capital gains deducted under the Income Tax Act (Canada). The maximum taxable capital gain on which a rebate will be paid, therefore, is $40,000 in 1985 and $25,000 in 1986. The maximum amount eligible for the rebate plus the amount eligible for the capital gains exemption will total $50,000.

3. Corporations winding up will be entitled to a rebate in the same manner as that outlined above for business people.

4. Applicants who are currently receiving their rebate over several years because of the purchase of income averaging annuity contracts or the creation of reserves will receive the balance of their rebate before the end of the year. If an applicant has not already filed form CG4 for 1985, that form should be submitted to the address below so that the balance of the Capital Gains Tax Rebate may be paid to the applicant.

5. All applications for a Capital Gains Tax Rebate must be submitted to the address below by December 31, 1987.

Application forms and further assistance are available from Saskatchewan Revenue, Supply and Services, Revenue Division, 3475 Albert Street, Regina, Saskatchewan S4S 6X6, telephone 787-6719 or 787-6540.

V. What You Should Know About Capital Cost Allowance

1. Depreciation vs Capital Cost Allowance

The original cost of machinery, equipment and buildings used in a business to earn income cannot be charged as an operating expense. However, these assets do wear out and become obsolete (depreciate). Therefore, farmers are allowed to charge as an annual expense for tax purposes, an amount called capital cost allowance. Capital cost allowance rates are stated in the Income Tax Regulations.

Depreciation is a business management and accounting term used to describe the decline in value of machinery, equipment and buildings as a result of use and obsolescence. Depreciation costs are often used in the calculation of business profits. These costs are determined in relation to the actual loss in market value of business assets or in proportion to how fast they are used up.

Since capital cost allowance rates are established by regulations, the amount claimed as an expense may be greater or less than depreciation; depreciation being the actual decline in the value of a capital asset.

2. Capital Cost Allowance Methods

Up to December 31, 1971, either of two methods for claiming capital cost allowance could be used by farmers. They were:

(i) Part XVII Method (Straight Line Method)
(ii) Part XI Method (Diminishing Balance Method)

The vast majority of farmers up to 1971 were using the more advantageous part XVII method. Farmers using the part XVII were allowed to switch over and use the part XI method. However, it was not possible to switch from part XI back to part XVII.

Since January 1, 1972, all depreciable capital assets must be placed on the part XI method. However, any assets that were on the part XVII schedule prior to 1972 could remain on that system until fully written off for capital cost allowance purposes.

(i) Part XVII Method
The following example illustrates the part XVII (straight line) method for a tractor purchased at a cost of $10,000 (15% capital cost allowance rate).

Example:

Year	Undepreciated Capital Cost	Capital Cost Allowance
1	$10,000	$1,500
2	8,500	1,500
3	7,000	1,500
4	5,500	1,500
5	4,000	1,500
5	2,500	1,500
7	1,000	1,000
	0	0

If the tractor was disposed of in the eighth year for $5,000, the amount received above the undepreciated capital cost ($5,000 - $0 = $5,000) would not be taxable. A capital gain would occur only if the proceeds of sale exceeded the original purchase price of $10,000 or valuation day value, whichever is the greater.

The following example illustrates the part XI (diminishing balance) method for a tractor purchased at a cost of $10,000. In this example, there is only one asset while in practice there are usually several assets grouped into a single class.

Year	Undepreciated Capital Cost (beginning of year)	Capital Cost Allowance	Undepreciated Capital Cost (end of year)
1	$10,000	$3,000	$7,000
2	7,000	2,100	4,900
3	4,900	1,470	3,430
4	3,430	1,029	2,401
5	2,401	720	1,681
6	1,681	504	1,177
7	1,177	353	824

If the tractor were sold in the eighth year for $4,000 and a replacement was not bought, the excess of the sale price over the undepreciated capital cost ($4,000 - $824 = $3,176) would be taxable as "recaptured" capital cost allowance. It has the same effect on taxable income as a grain sale of $3,176.

Capital gains would occur only if the proceeds exceeded the original cost of $10,000.

In actual practice, the part XI method is more complex than the above example illustrates. As assets are purchased, their cost is added to the appropriate class. As part XI assets are sold, the proceeds of sale are deducted from the appropriate class. The amount deducted from the class on a sale cannot exceed the original purchase price. For example, if a machine was originally purchased for $5,000 and was sold several years later for $6,000, only $5,000 would be deducted from the class. However, the taxpayer would report a $1,000.00 capital gain ($6,000 - $5,000 = $1,000).

When a part XVII asset is traded in on a new asset, the proceeds of the sale of the part XVII asset are not deducted from the part XI class. The following example illustrates the addition and sale of several assets and the effect on the part XI method. It assumes that the farmer has used the part XVII method up to 1972. Class 10 (maximum rate of 30%) is used and the business investment tax credit is ignored.

Example:

A. Capital Transactions

	1972	1973	1974	1975	1976
Capital Purchases	$10,000 (Tractor)	Nil	$6,000 (Truck)	$12,000 (Tractor)	$ Nil
Capital Sales	$ 4,000 (Part XVII Tractor)	Nil	$3,000 (Part XVII Truck)	$ 8,000 (1972 Tractor)	$10,000 (1975 Tractor)
					$ 4,000 (1974 Truck)

B. Class 10 Schedule

Undepreciated Capital Cost from Previous Year	0*	$7,000	$4,900	$ 7,630	$ 8,141
+ Cost of Additions	$10,000	Nil	$6,000	$12,000	Nil
- Proceeds of Sale	Nil**	Nil	Nil	- 8,000	-$14,000
Undepreciated Capital Cost	$10,000	$7,000	$10,900	$11,630	***$5,859 Recaptured CCA
Capital Cost Allowance	$3,000	$2,100	$3,270	$3,489	
Undepreciated Capital Cost at End of Year	$7 000	$4,900	$7,630	$8,141	

* The part XVII method has been used up to 1971, therefore, the part XI method would begin in 1972 with a beginning balance of 0.

** Since the traded tractor was originally a part XVII asset, the proceeds of sale are not deducted from the class.

*** When the assets are disposed of from a class leaving a negative balance, a recapture occurs. It is considered as income for income tax purposes. When the assets in a class are completely disposed of, but a positive balance remains, a "terminal loss" occurs. It is treated like an expense.

Table 5 provides a comparison of the two capital cost allowance methods.

Table 5
Comparison of the Two Capital Cost Allowance Methods

	Part XVII	Part XI
Base on which rates are calculated	Original cost each year	Balance of undepreciated capital cost remaining from the previous year
Capital cost allowance rates	Buildings - 5% Pull-type equipment - 10% Self-propelled equipment - 15% (Less than the maximum rate may be claimed)	Buildings - 10% (Class 6) Pull-type equipment -20% (Class 8) Self-propelled equipment - 30% (Class 10) (Less than the maximum rate may be claimed)
Organization of schedule	Each asset listed and capital cost allowance calculated individually	Assets are grouped into similar classes: Buildings - Class 6 Pull type equipment -Class 8 Self-propelled equipment -Class 10 Capital cost allowance is claimed on the total combined value of each class

Effect of date of purchase or sale or the amount of capital cost allowance which may be claimed	When an asset is sold or purchased, capital cost allowance may be claimed only for the number of months owned (i.e. after the date of purchase or up to the date of sale) e.g. A sale in August would allow 8/12 of the full year's capital cost allowance	For purchases after November 12, 1981, one-half of the maximum rate may be claimed in the year of purchase. Full rates may be claimed in subsequent years. No capital cost allowance may be claimed in the year in which an asset is sold.
Recaptured capital cost allowance	Non-taxable	Fully taxed when realized
Terminal loss	Not deductible from income	Deductible from income
Capital gains	Taxed if proceeds of sale exceed higher of original cost or fair market value on Valuation Day value (if applicable)	Taxed if proceeds of sale exceed higher of original cost or fair market value on Valuation Day value (if applicable).
Business and personal use	When assets are used partly for business and partly for personal use only the share used for business may have capital cost allowance claimed (e.g., cars, homes, snowmobiles)	When assets are used partly for business and partly for personal use, only the share used for business may have capital cost allowance claimed (e.g., cars, homes, snowmobiles)

3. Half Rate Rule

The half rate rule applies to Part XI assets acquired after November 12, 1981. This rule provides that only one-half of the full capital cost allowance rate may be claimed on assets in the year of purchase. The full rates may be used in subsequent years.

When a depreciable asset is purchased and a trade-in is involved, only the additional cost or cash difference on the transaction will be subject to the half-rate rule.

Since assets under the Part XI method of capital cost allowance are grouped in classes, an adjustment to the capital cost allowance schedule is required to account for the half-rate rule. The adjustment is made by reducing the undepreciated capital cost after including additions and disposals during the year by one-half of the amount by which the cost of additions exceed the proceeds from disposals. If the proceeds of disposals exceed the cost of additions then no adjustment occurs. The following example illustrates this adjustment:

Purchase tractor	$ 50,000
Trade-in tractors	20,000
Cash difference	$ 30,000
Undepreciated capital cost at beginning of year	$ 70,000
Cost of additions*	+ 50,000
Proceeds from disposals	-20,000
Undepreciated capital cost after additions and disposals (A)	$100,000
One-half of additions minus disposals 1/2 ($50,000 - $20,000)	-15,000
Sub total	$ 85,000
Capital cost allowance 30% on $85,000 (B)	$ 25,500
Undepreciated capital cost at end of year (A - B)	$ 74,500

* Cost of additions would be reduced by any investment tax credit claimed on new assets.

The half-rate rule does not apply when depreciable property is transferred in a non-arm's length transaction if the taxpayer owned the property for at least 365 days, nor if the property was not originally subject to the half-rate rule.

Assets placed in class 12 (small tools) are not subject to the half-rate rule.

4. Switching from Part XVII to Part XI

Farmers should not switch part XVII assets to the part XI method, except in unusual circumstances. Recaptured capital cost allowance is not taxable under the part XVII method, but is taxable under the part XI method. Whenever assets are switched from part XVII to part XI, it must be a complete switch of all part XVII assets. Even part XVII assets which have been fully written off for capital cost allowance purposes must be switched. Since the proceeds of sale of capital assets usually exceed the undepreciated capital cost, a switch from part XVII to part XI would eventually result in taxable recaptured capital cost allowance.

Example:

A tractor was purchased in 1965 for $8,000 and depreciated under the part XVII method. It is now fully depreciated. If this tractor was transferred from part XVII to part XI and sold for $4,000, recaptured capital cost allowance of $4,000 (4,000 - 0) would become taxable. If the tractor had remained on the part XVII method, there would be no taxable recaptured capital cost allowance.

5. Family Transfers of Machinery and Buildings (Rollovers)

Part XI machinery, equipment and buildings may be transferred from parent to child at a price which does not bring about taxable capital gains or recapture of capital cost allowance. The rules governing such rollovers are similar to those for farm land (see section IV for details).

Rollovers as such do not apply to part XVII assets. However, they may be transferred to children at any value not greater than fair market value. In the transfer of Part XVII assets to children, the greatest benefit to the child occurs when the transfer value is at fair market value, since the child's capital cost allowance is based on the transfer value used.

Table 6 summarizes how to determine the transfer values for tax purposes when depreciable assets are transferred in various ways.

Table 6
Transfer Values of Depreciable Assets
F.M.V. = Fair Market Value
U.C.C. = Undepreciated Capital Cost

Type of Transfer	Capital Cost Allowance Method	Transfer to: Stranger	Child	Spouse
Sale	Part XVII	Sale Price	Sale Price	Seller's Cost
	Part XI	Sale Price U.C.C.*	F.M.V. to U.C.C.	
Gift	Part XVII	Nil	Nil	Donor's Cost
	Part XI	F.M.V. U.C.C.*	F.M.V. to	U.C.C.
Bequest	Part XVII	F.M.V.	F.M.V.	Deceased's Cost
	Part XI	$\frac{\text{U.C.C. + F.M.V.}}{2}$	U.C.C.	U.C.C.

* If the cash amount received by the parent falls between the F.M.V. and U.C.C. then the cash amount received is the transfer value. If the cash amount received exceeds the F.M.V., then the F.M.V. is the transfer value. If the cash amount received is less than U.C.C., then the U.C.C. is the transfer value.

6. The Business Investment Tax Credit

Saskatchewan farmers may deduct from federal tax payable 10 per cent of the price they pay for new (never used) buildings and machinery used in the business of farming. Cars, some trucks and assets not used primarily in the business of farming do not qualify. Trucks with a gross vehicle weight rating as established by the manufacturer of over 26,000 lbs. qualify. Since trucks are classified as transportation equipment, the credit is 7% rather than 10% as is the case for other assets. The 10 per cent tax credit is effective for purchases after November 16,1978. The rate was 5 per cent prior to April 1, 1977 and 7.5 per cent up to November 16, 1978. The business investment tax credit does not reduce the provincial tax otherwise payable.

Investment tax credits earned after April 19, 1983 can be used to reduce federal tax payable without any limitation. Prior to this, the investment tax credit claimed in a year could not exceed $15,000 plus one-half of the federal tax payable in excess of $15,000.

After April 19, 1983, any investment tax credit earned which exceeds federal tax payable may be carried back three years or forward seven years. The three year carryback provision was be phased in, with a two year carryback permitted in 1983 and the full three year carryback permitted in 1984. Prior to April 19, 1983, no carryback was permitted however, there was a five year carry forward.

There is a direct refund of a portion of investment tax credits earned between April 19, 1983 and December 31, 1988 where a taxpayer does not have sufficient federal tax payable to fully utilize the available investment credit. Farmers, small business corporations and unincorporated businesses will be eligible for a 40 percent refund of unused investment tax credits. The refund will be 20% for all other businesses. The portion of the investment tax credit not received as a refund can be carried back three years or forward seven years.

The business investment tax credit is based on the full purchase price of an asset. If a trade in was involved, the credit is based on the purchase price of the new asset, not the cash difference on the transaction. The amount of business investment tax credit applied against federal tax payable must be used to reduce the capital cost of the asset which generated the credit. For example, if a $50,000 new tractor was purchased, the business investment tax credit would be $5,000 ($50,000 x 10.0%). The cost of the new tractor for capital cost allowance and capital gain purposes is $45,000 ($50,000 - $5,000).

If an asset is purchased in one year, but the credit is not applied against federal tax payable until a later year, then the full capital cost of the asset should be included in the capital cost allowance schedule in the year of purchase. The cost of the asset and a reduction to the capital cost allowance schedule should be made in the year in which the federal tax payable is reduced by the credit.

Prior to 1983, it was possible to claim the investment tax credit twice when a five year block average was applied. However, this will not be permitted for 1983 and subsequent years.

Farmers who purchased new buildings or machinery in prior years, but neglected to claim the credit may do so by amending the affected income tax returns.

The February 26, 1985 federal budget introduced provisions to phase out the investment tax credit. The phase out will occur as follows:

	1986	1987	1988	1989
7% Rate	5%	5%	3%	0%
10% Rate	10%	7%	3%	0%

Individuals considering purchasing new assets should utilize the higher rates available in 1986 and 1987.

Farmers should also be aware that Revenue Canada has adopted a new policy and are currently attempting to reassess taxpayers to reduce the trade-in value to their estimate of fair market value. This, in turn, would reduce the purchase price of the new equipment and, consequently, reduce the BITC. Caution should be exercised when determining a trade-in value.

7. Should the Maximum Capital Cost Allowance Always be Claimed?

If you are not paying income tax and do not expect to in the near future do not claim the maximum capital cost allowance. Otherwise, you may not be able to take advantage of personal exemptions, tax-free income levels or Canada Pension Plan contributions.

If you plan to claim only part of your capital cost allowance, claim it on the following priority basis:

(i) Part XVII assets
(ii) Those part XI assets with the lowest capital cost allowance rates (e.g. buildings, class 6-10%)

If you are consistently paying income taxes or you expect a high taxable income in the near future, claim the maximum capital cost allowance each year, whether the assets are on part XVII or part XI. If the reduction of capital cost allowance brings about a loss, the loss can be applied to reduce income for the three previous years or any year up to ten years in the future.

In effect when you create a loss by using capital cost allowance, and apply that loss against a year of profit, you are applying the capital cost allowance deductions for two years (the loss year and the profit year) against the income of the profit year. Personal

exemptions cannot be carried with the business loss to apply against income in other years, but they can be recovered using a five-year block average.

The following example illustrates two situations. In Situation I, no capital cost allowance is claimed in the year of loss and in Situation II, maximum capital cost allowance is claimed in the year of loss:

Example:

Assumptions:
- 1986 income tax rates
- a five year block averaged was applied in the year prior to Year 1, therefore no business loss was carried back.
- Personal exemptions are $9,000.00
- All capital cost allowance claimed is under part XI

	Situation I		Situation II	
	Year 1	Year 2	Year 1	Year 2
Income	$15,000	$40,000	$15,000	$40,000
Expenses	-15,000	-15,000	-15,000	-15,000
Capital Cost Allowance	Nil	5,000	-5,000	-4,000
Business Loss-Carry Forward	Nil	Nil	Nil	-5,000
Net Income	Nil	20,000	-5,000*	16,000
Personal Exemptions	-9,000	-9,000	-9,000	-9,000
Taxable Income	Nil	11,000	Nil	7,000
Income Tax	Nil	2,872	Nil	1,530
Two Year Income Tax Total		$ 2,872		$ 1,530
Savings By Claiming Capital Cost Allowance in Year 1			$1,342	

*The business loss could not be carried back and therefore is carried forward and applied against income in year 2.

8. Trading In Machinery

When a farmer is purchasing a machine to replace one that was on part XVII (pre-1972) he may have two choices:

(a) Purchase the new machine for cash and sell the used one

or

(b) Purchase the new machine and trade in the used one.

The best alternative depends on the cash outlay for both alternatives and the farmer's marginal tax rate.

Example:

Assume that a used swather is on the part XVII method of Capital Cost Allowance and has an original cost of $13,000.

Alternative A

Purchase new S.P. swather (cash - no trade)	$20,000
Sell used swather for cash (separate transaction)	$10,000
Cash Difference	$10,000

Alternative B

Purchase new S.P. swather at list price	$23,000
Trade-in used swather (same transaction)	$12,500
Cash Difference	$10,500

The farmer can claim $3,000 more capital cost allowance over time with Alternative B. Note that no deduction is made from the part XI class for the sale or trade of the part XVII combine.

The additional capital cost allowance of $3,000 in Alternative B costs $500 extra in immediate cash outlay. However, in even a modest income tax bracket, Alternative B would still give the greatest advantage as a result of the income tax savings.

When a farmer is trading in a part XVII machine, he gets the greatest tax advantage by buying the new machine at its list price, the trade-in being valued accordingly. Over time he can claim the greatest possible deduction for capital cost allowance on his part XVII trade-in.

9. Capital Gains on Machinery Trades

In some situations, the trade-in value of either a part XVII or part XI machine will be high enough to create a capital gain. It is better to incur this capital gain than to set the trade-in values such that there is no capital gain:

Example:

- Original cost of trade-in: $9,000
- Class 10 machine

	Alternative A	Alternative B
Price of new machine	$19,000	$22,000
Trade-in Value	9,000	12,000
Cash Difference	10,000	10,000
Effect on Class 10		
Cost of new machine	19,000	22,000
Less trade-in value not exceeding original cost	9,000	9,000
Net change	$10,000	$13,000

Alternative B increases the capital cost allowance by $3,000 but results in a capital gain on the old machine, as follows:

Capital Gain	A	B
Trade-in value	$9,000	$12,000
Original Cost	9,000	9,000
Capital Gain	0	3,000

By selecting Alternative B, the farmer will have $1,500 more income in the form of taxable capital gain in the year of trading, but he can claim additional capital cost allowance under the half rate rule of $450 (1/2 of 30% x $3,000). Thus he will have $1,050 more taxable income in the first year but will have an additional $2,550 capital cost allowance to claim in future years. Alternative B is likely a better choice unless the farmer expects to be non-taxable in the future.

By selecting Alternative B, a farmer will have increased his capital cost allowance by $3,000 to be used in future years. He has also triggered a $3,000 capital gain. However, this amount is eligible for the lifetime capital gains exemption. Alternative B is likely to be the best choice.

It should be noted, however, that with the capital gains exemption, the handling of non-arm's length transfers of depreciable assets has changed. Where a taxpayer has acquired depreciable property of a prescribed class in a non-arm's length transaction after May 22, 1985 the property will be treated, for the purposes of the rules relating to capital cost allowance, as having been acquired at the transferor's original capital cost and, where the transferor's capital cost exceeds the transfer value, the difference between those values is treated as capital cost allowance previously claimed by the taxpayer.

Taxpayers have in the past been able to increase the amount available for non arms length transfer where the fair market value of the depreciable asset exceeded its original capital cost. There was usually a benefit derived from this because the tax savings from the increased CCA was greater than the transferor's tax on the capital gain. Now, because the capital gain is tax exempt, the transfer value can not exceed the transferor's original capital cost.

10. Purchasing Machinery to Save Income Tax

Often machinery is purchased to save income tax. However, such decisions may not be the most profitable. For example, an additional $5,000 invested in a machine will save only $2,000 income tax over a period of years if the farmer is in a 40% tax bracket. As a general rule of thumb, it does not pay to purchase machinery to save income tax unless other benefits are realized.

Other factors to consider when purchasing machinery include the following:

(i) Does the present machine need replacing because of high repair bills, unreliability, obsolescence, or expansion to the farm business?

(ii) Inflation — will the machine cost more to purchase in the future?

(iii) Will the new machine increase the productivity of the business and reduce labor requirements? Could this money be invested more profitably elsewhere?

(iv) What are the added fixed costs of the new machine (depreciation, interest on investment, insurance)?

(v) What effect does it have on cash flow or savings?

(iv) Do you plan to get out of the business of farming in the near future?

The following example illustrates a procedure to analyze both the income tax and business management aspects of a machinery purchase decision.

Example:

Assumptions:
- 1986 Income Tax Rates are used.

Capital Transactions

New Tractor (list price)	$50,000
Trade-in (Part XI - Cost $25,000)	20,000
Cash Difference	$30,000

Business Investment Tax Credit
50,000 x 10.0% = $5,000

Effect on Part XI Capital Cost Allowance

Addition to class 10	
($50,000 - $5,000)	$45,000
Disposal from class10	20,000
Net addition to class 10	$25,000

Extra Capital Cost Allowance

Year 1 - 1/2 x 30% x $25,000	$ 3,750
Year 2 - 30% x $21,250	$ 6,375

Extra Interest on Investment

Year 1 - $30,000 x 10%	$ 3,000
Year 2 - $24,000 x 10%	$ 2,400

A. The Income Tax Effect

	Year 1		Year 2	
	Tractor is Not purchased	Tractor is Purchased	Tractor is Not Purchased	Tractor is Purchased
Income	$95,000	$95,000	$95,000	$95,000
Cash Expenses	-45,000	-45,000	-45,000	-45,000
Interest	-	-3,000	-	- 2,400
Sub-Total	50,000	47,000	50,000	47,600
Capital Cost Allowance	-10,000	-13,750	-8,000	-14,375
Net Income	40,000	33,250	42,000	33,225
Personal Exemptions	- 9,000	- 9,000	- 9,000	-9,000
Taxable Income	31,000	24,250	33,000	24,225
Income Tax Payable				
Federal Tax Calculation	6,425	4,697	6,958	4,690
Less Business Investment Tax Credit	nil	5,000	nil	303
Federal Tax Payable	6,425	- 6,958	4,387	
Provincial Tax Payable	3,557	2,647	3,827	2,643
Total Tax Payable	$ 9,892	$ 2,647	$10,695	$ 7,030
Income Tax Saving		$7,245		$3,665

B. The Combined Tax and Management Effect When the Tractor is Purchased

	Year 1		Year 2	
1. Cost and Income Advantages				
- Reduced Income Taxes	$7,245		$3,665	
Total Advantages		7,245		3,665
2. Cost and Income Disadvantages				
- Extra Interest	3,000		2,400	
- Extra Depreciation* $30,000 x 15%	4,500		3,825	
- Extra Insurance	75		65	
Total Disadvantages		7,575		6,290
Net Benefit		- $ 330		- $2,625

* This is actual depreciation, not capital cost allowance.

The farmer in the example, having purchased the machine, is worse off by $330 in the first year and by $2,625 in the second year when both business management and income tax aspects are considered. These disadvantages increase with time. As well, the income tax may be deferred rather than saved. If the tractor is sold for more than its depreciated value recaptured capital cost allowance will occur.

Machinery and building purchase decisions should not be based only on the income tax effect. Other factors need to be considered at the same time such as repair costs, inflation, productivity, labor, timeliness of operation, extra fixed costs and cash flow. The effect of the decision on more than just the first year should be looked at. Finally, each situation is different. No general recommendation can be made except that it is never wise to purchase machinery or buildings just to save income tax.

VI. What You Should Know About Averaging and Deferring Income

1. Why Average or Defer?

Farm incomes rise and fall from year to year. Our tax system levies progressively higher tax rates on higher levels of income. By averaging income from high income years with that of lower income years, a taxpayer is able to reduce total taxes payable.

Example

	No Averaging		
	Year 1	Year 2	Year 3
Taxable Income	$0	$60,000	$0
Tax Payable	$0	$23,756	$0

	Averaging		
	Year 1	Year 2	Year 3
Taxable Income	$20,000	$20,000	$20,000
Tax Payable	$ 5,761	$ 5,761	$ 5,761

Tax Savings from
Averaging = $23,756 - $17,283 = $6,473

Whether or not to defer income depends upon your individual circumstances. It is not always best to reduce taxable income to as low a level as possible each year. In doing so, you may not be achieving the largest net after-tax income possible over the long run.

It is most important to use up farm losses, restricted farm losses, capital losses, and investment tax credits carried forward from previous years. If not used within the time limits specified in the Income Tax Act, these credits may be lost. Do not defer income and have no taxable income in a year when these deductions could be claimed.

In 1986, you can have a taxable income of roughly $2,700 and pay only $300 in taxes. If you have $9,000 personal exemptions, you can have a net income of $11,700 ($9,000 + 2,700) without paying much income tax. Indexing of tax rates and personal exemptions will raise this figure in the future.

If you are an older farmer, you may wish to make maximum contributions to the Canada Pension Plan. If so, do not defer income below the maximum qualifying income ($23,300 in 1986).

Averaging and deferral methods should be used to achieve an even flow of income, not necessarily to minimize current income tax. Misuse of these methods will result in a higher tax burden in the long run. Wise use will bring about a higher final after-tax income.

2. Deferral and Averaging Methods

(i) Within Year

Farmers on the cash method accounting may, through careful management, achieve a steady even flow of income from year to year. They can incur more expenses during a particular high income year and also defer income to the following year through management techniques such as the following:

- Pay outstanding accounts for feed, fertilizer, seed, supplies and other cash expenses.
- Purchase crop inputs, feed and supplies for the upcoming year
- Purchase livestock
- Purchase needed machinery and buildings (see "Purchasing Machinery to Save Income Tax", Section V).
- Postpone marketing grain or livestock until after beginning of next taxation year.
- If marketing grain, deliver under a deferred ticket or storage ticket.

These management tools, although potentially useful are often misunderstood and misused. This results in large, unmanageable lump sums of income being deferred to a particular year. As well, to use the tools, a farmer must forego immediate income, buy or sell at the wrong time and have more interest and storage costs. When evaluating these tools, good farm records are essential. Consider the following:

- The effect of the income and expense adjustments in both the current year and future years
- Interest foregone by delaying sales or purchasing inputs
- Interest that can be earned on the tax saved in the year of deferral
- Current and future prices and quotas for products marketed
- Added storage costs and losses in storage
- Other uses for the after-tax income on the farm or in the family

The following three examples use deferred grain tickets to illustrate how to evaluate the effects of deferring income for declining, stable and increasing income.

Example:

Assumptions
Deferral on grain valued at $10,000
Interest rate 10%
Tax rates used: Year 1 - 1986
Year 2 - 1987

Taxable incomes without deferral

Declining:	Year 1 - $30,000
	Year 2 - $10,000
Stable:	Year 1 - $20,000
	Year 2 - $20,000
Increasing	Year 1 - $15,000
	Year 2 - $25,000

* 1987 rate the same as 1986.

Calculations

A. Declining income, 6 month deferral

	No Deferral			Deferral		
	Year 1	**Year 2**	**Total**	**Year 1**	**Year 2**	**Total**
Taxable Income	$30,000	$10,000	$40,000	$20,000	$20,000	$40,000
Income Tax	9,870	2,474	12,344	5,761	5,761	11,522

Difference in income tax paid = $12,344 - $11,522 = +$822

Less interest income foregone for 6 months = $10,000 x 10% x $\frac{6 \text{ months}}{12 \text{ months}}$ = -$500

Plus interest for 12 months on tax savings for one year = ($9,870 - $5,761) x 10% = +$410

Therefore, net gain in income = +$732

B. Stable income, 6 month deferral

	No Deferral			Deferral		
	Year 1	**Year 2**	**Total**	**Year 1**	**Year 2**	**Total**
Taxable Income	$20,000	$20,000	$40,000	$10,000	$30,000	$40,000
Income Tax	5,761	5,761	11,522	2,474	9,870	12,344

Difference in income tax paid $11,522 - $12,344 = -$822

Less interest income foregone for 6 months = $10,000 x 10% x $\frac{6 \text{ months}}{12 \text{ months}}$ = -$500

Plus interest income received for 12 months on tax savings for one year = ($5,761 - $2,474) x 10% = +$329

Therefore, net loss in income = -$993

C. Increasing income, 6 month deferral

	No Deferral			Deferral		
	Year 1	**Year 2**	**Total**	**Year 1**	**Year 2**	**Total**
Taxable Income	$15,000	$25,000	$40,000	$5,000	$35,000	$40,000
Income Tax	4,106	7,644	11,750	922	11,877	12,799

Difference in income tax paid = $11,750 - $12,799 = -$1,049

Less interest foregone for 6 months = $10,000 x 10% x $\frac{6 \text{ months}}{12 \text{ months}}$ = -$500

Plus interest income received for 12 months on tax savings for one year ($4,106 - $922) x 10% = +$318

Therefore, net loss in income = -$1,231

Summary of Effects of Deferring for Varying Periods

Deferral Period	Declining Taxable Income	Stable Taxable Income	Increasing Taxable Income
1 month	$1,149	$ -576	$ -814
2 months	1,066	-659	-897
3 months	983	-742	-980
4 months	900	-825	-1,063
5 months	817	-908	-1,146
6 months	732	-993	-1,231
12 months	232	-1,493	-1,731

Deferral of income can be beneficial when it is expected that net income will decline in the future, providing the deferral period is not too long and tax rates don't change that dramatically. However, you may be deferring income into a new tax scheme which could increase your average tax. It is definitely a losing proposition when net incomes are stable or are expected to increase in the future. However, some of the adverse tax consequences of deferring income in years of stable or increasing income can often be overcome by block averaging in the year in which the deferred amount is brought into taxable income.

The above examples also indicate the beneficial tax effect of achieving a uniform, even flow of income over time. To the extent that adjustments to income result in a similar taxable income between years, the effect on profit is positive. To the extent that the adjustments to income result in greater variability of income between years, the effect on profit is negative.

(ii) Registered Retirement Savings Plans

Retirement savings plans which are registered with Revenue Canada enable an individual to reduce his immediate taxable income within certain limits and build a retirement fund. Many financial institutions (e.g. banks, credit unions, life insurance, trusts and investment companies) are authorized to handle Registered Retirement Savings Plans (R.R.S.P.). They may offer one or more plans depending on where they invest the money received. This can include bonds, preferred or common shares of Canadian and non-Canadian corporations (subject to certain restrictions), first mortgages, and interest bearing investments. The individual's contributions are invested in such a way that the contributions and accumulated profits of the plan are not taxable until withdrawn by the individual.

Funds withdrawn from an R.R.S.P. are taxable in the year of withdrawal. A partial withdrawal of funds cannot be made without deregistering (cancelling) the original R.R.S.P. However, if you wish to withdraw only a portion of the funds, you can transfer that portion which you want left to another R.R.S.P. and then deregister the original plan.

To average out R.R.S.P. income over a number of years, a taxpayer may use the funds to purchase one of the following:

1. A life annuity which returns a minimum of one payment per year for life.

2. A life annuity with a guaranteed term which pays out throughout his life but guarantees payment for a specified number of years and pays out the balance to the estate should he die before the end of the term.

3. An annuity with a term in length equal to 90 minus the taxpayers age.

4. A Registered Retirement Income Fund which pays out increasing amounts each year up to his 90th birthday. Any balance remaining at death (before 90) is paid out to his estate.

Generally, the more guaranteed options have lower returns. The life annuity option above gives the taxpayer the most income protection. The guaranteed options protect his equity in case of death.

Two other alternatives exist for spreading out income from R.R.S.P. withdrawals. One is to have several R.R.S.P.'s, each with relatively few funds, and to deregister them individually over a number or years. The other relates to the provision that funds can be transferred from one R.R.S.P. and effectively withdraws only a portion of the funds. This alternative should be used only where service charges, deregistration penalties and other fees are low enough to make it worthwhile.

Currently, a self-employed Canadian taxpayer who has not reached the age of 71 can contribute 20% of his earned income up to a maximum of $7,500 per year to registered retirement savings plans for the 1986 taxation year. Also effective in 1986, all individuals who are currently a member of a defined benefit pension plan will not be subject to a maximum contribution limit of $3,500. For all individuals currently enrolled in a money purchase pension program, the $3,500 limit will still apply. The taxpayer's earned income includes net income, salary or wages, pension benefits, death benefits, royalties, business or rental income from real property (e.g. land and buildings) less any business or rental losses. Earned income does not include investment income such as stocks, bonds, mutual funds, guaranteed investment certificates and bank accounts. Capital gains are also excluded.

Contributions made during the year and within sixty days after the year end are eligible as deductions from income

A husband may contribute all or part of his allowable amount to an R.R.S.P. for his wife. This allows hus-

band and wife to split their retirement income and usually have higher total deductions as individuals than as a couple. For example, if both husband and wife have life annuities purchased from R.R.S.P. funds, they could each use the $1,000 pension income exemption for which the annuity payments qualify. If the wife does not have a plan only the husband could use this deduction. Since March 31, 1977, if the wife withdraws from the plan within three years of the husband's contribution, the withdrawal will be taxed as income of the husband.

At death the fair market value of a Registered Retirement Savings Plan or Registered Retirement Income Fund or annuity are taxable income to the estate. However, if the benefits are transferred to a spouse or dependent child or grandchild the tax is deferred.

Of particular interest to farmers is that registered retirement savings plans are not assignable and, therefore, cannot be used as collateral when borrowing money. Another thing to consider is that fixed contracts, whereby equal annual payments are made to a plan may be undesirable because the tax advantage will be almost non-existent in years of low taxable income.

Whether or not a farm is well established is an important factor in deciding if the registered retirement savings plan is the best use of the operator's money. If a farmer can profitably expand or improve his farm business an R.R.S.P. may be of little benefit especially if he is in a lower income tax bracket. A farmer can gain the same income deduction for buying farm inputs, such as fertilizer, as he would for investing the same amount in a R.R.S.P., and the farm inputs may be a better investment.

Since there are many different options available it is advisable to compare the plans of several companies to find the one most suitable for the individual circumstances. Factors to consider are the loading fees when the plan is purchased, annual service charges, penalties for deregistering, notice required prior to withdrawing from the plan and past performance of the plan. It may be important whether the company handles the purchases of a life annuity or if the plan holder does this.

Changes were first proposed for R.R.S.P.s in the May 23, 1985 Federal Budget. These changes have been on hold and will not take place until 1988. The years 1986 and 1987 represent transition years. For 1986 individuals who are not members of a registered pension plan (R.P.P.) or deferred profit sharing plan, may contribute up to 20% of their earned income to a maximum of $7,500. Members of pension plans can contribute up to 20% of their earned income to a maximum of $3,500 (less any employee contribution to a pension plan). Under the defined benefit plan, the employee's contributions are not limited to $3,500.

For farmers, the following changes will take place:

(a) Limits will increase:

Year	R.R.S.P.* Limits
1986	$ 7,500
1987	7,500
1988	9,500
1989	11,500
1990	13,500
1991	15,500

* Based on the lesser of 18% of earned income of the previous year or the limit mentioned.

(b) Taxpayers will be allowed to carry forward any unused contribution for up to seven years, beginning in 1988.

(c) You will be allowed to mature your R.R.S.P. at any time before December 31 of the year you turn 71 as opposed to age 59 under the old system.

With regard to money purchase pension plans, the limits will also increase. The limits are as follows:

Year	R.P.P.* Limit
1986	$7,000
1987	7,000
1988	11,500
1989	13,500
1990	15,500
1991	15,500

* Based on the lesser of 18% of earned income of the previous year or the limit mentioned. The limit mentioned would include the employer's contribution as well.

The calculation for a defined benefit pension plan is quite different. A member of this plan will have a pension adjustment which reflects the current value of benefits accrued under the plan. A formula exists to determine the additional amount which can be contributed. The pension benefits are determined (provided by employer) and from that the additional contributions are calculated. For example, if the maximum contribution is $9,000 and your pension benefits are roughly three-quarters then you can contribute $2,250 plus $600 (ad hoc figure set by Revenue Canada) or $2,850 in R.R.S.P.

(iii) Optional Inclusion of Value of Livestock on Hand

Livestock farmers on the cash basis are permitted to add to their farm income in any taxation year an amount up to but not exceeding the fair market value of the livestock on hand at the end of the taxation year. Any amount added to income in one taxation

year must be deducted as a farm expense in the following taxation year. This procedure can be repeated each year.

The term "livestock" includes cattle, horses, sheep, swine, poultry, fur bearing animals and bees. Animals included in a "basic herd" cannot be used for this provision.

The Statement of Farming Income and Expenses in the Farmer's Income Tax Guide provides two lines to record the Optional Inclusion of Value of Livestock on Hand. To add onto the current year's income, record the amount on the income side beside the heading "Optional Value of Livestock, end of current year". To deduct an amount added to the previous year's income, record the amount on the expense side beside the heading, "Optional Value of Livestock, end of previous year". Maintain a record of how the amount was determined and file two copies of this record, one with the current year's income slips and the other with expense receipts for the upcoming taxation year. This helps one to remember the source of the extra livestock "income" for the current year, and also to deduct the amount as a livestock expense on the tax form the following year.

The following example illustrates the use of the Option Inclusion of Value of Livestock on Hand:

Example:

Assumptions - 1986 tax rates
- December 31 livestock inventory value $50,000 each year.

Without Optional Inclusion of Value of Livestock

	Year 1	Year 2	Year 3
Net Income	$ 0	$15,000	$30,000
Less Personal Exemptions	-8,000	-8,000	-8,000
Taxable Income	-$8,000	$ 7,000	$22,000
Tax Payable	$ 0	$ 1,530	$ 6,477

Total Tax (3 years) = $8,007

With Optional Inclusion of Value Livestock

	Year 1	Year 2	Year 3
Net Income	$ 0	$15,000	$30,000
Less Optional Value of Livestock, end of previous year	0	-10,000	- 5,000
Plus Option Value of Livestock, end of current year	+ 10,000	+ 5,000	0
Less Personal exemptions	- 8,000	- 8,000	- 8,000
Taxable Income	+ $2,000	+ $2,000	+ $17,000
Tax Payable	$ 192	$ 192	$ 4,806

Total Tax (3 years) = $5,190

Tax Saving = $8,007 - $5,190 = $2,817

There are many uses of this option, such as:
- To ensure farm losses do not expire.
- To utilize personal exemptions and the first $2,000 (for 1986 taxation year) of taxable income which has a low rate of tax in the year of loss. This way the farmer does not have to wait for a five year block average to recover unused personal exemptions.
- To average income by using the provision in low income years and not in high income years.
- When beneficial, to raise income in the last year of a block average, in order to derive benefit from the block average.
- To increase income to permit maximum contributions to the Canada Pension Plan or to a registered retirement savings plan.
- To claim maximum capital cost allowance in the year of the loss.

(iv) Agreements for Sale

Agreements for sale provide a means of forward averaging taxable income including capital gains. Farmers who sell livestock, grain, feed or other produce under an agreement for sale may declare the income in those years that payments are received rather than reporting the income in its entirety in the year of sale. For example, a father may sell $5,000 worth of livestock to a son under an agreement for sale. With payments of $1,000 per year for five years, the father avoids being taxed on $5,000 in the year of sale but includes with his income $1,000 for each of five years. Such an agreement for sale includes a fixed repayment schedule but it is not necessary to charge interest since there are no longer gift tax consequences where interest is not charged. If interest is charged the son could use the interest as an expense but the father would have to declare it as income.

(v) Reserves

The tax on capital gain (but not on recaptured capital cost allowance) associated with land, machinery and buildings sold whereby the vendor finances the transaction can be averaged using a "reserve." A reserve is a means of deferring the tax on certain types of income which are owing to a taxpayer but are not received by him in the taxation year in which the reserve is claimed.

It should be noted that the capital gains exemption is restricted to capital gains which arose in 1985 or which will arise in 1986 and subsequent years. The exemption is normally restricted to the year in which the property is sold in spite of the fact that the payments maybe spread over a period of years. Therefore, the exemption cannot be used to offset a capital gain which arises from the inclusion of a prior years capital gain reserve. However, farmers selling farm property over time can use capital gains reserves for post 1984 sales and claim the capital gains exemption on the reserve each year. This special provision for the sale of farm property minimizes the impact of the alternative minimum tax. The capital gain reserve resulting from a sale prior to

January 1, 1985 will be taxable as the capital gains exemption can not be used for pre-1985 reserve.

Under an agreement for sale, a sale or where a mortgage is set up for payment of the price, the vendor (seller) does not receive the entire sale price at once. Therefore, the vendor can deduct a reserve.

The amount that may be claimed as a reserve depends on the date the contract was finalized.

(a) Transactions Prior to November 13, 1981
A vendor may declare a reserve that is in proportion to the amount of principal still outstanding. In effect, the vendor declares as taxable income only the portion of the total taxable capital gain which he receives each year. All agreements completed by November 12, 1981 are subject to the above regulations even though payments may extend beyond November 12, 1981.

(b) Transactions after November 12, 1981
The amount of reserve that may be claimed depends on the terms of the contract, the type of property, and the relationship between the vendor and the purchaser. There are now three classes of reserves, as follows:

Ten Year Reserve for Family Farms and Small Business Corporations
If the property is family farm property, shares of a family farm corporation, an interest in a family farm partnership or shares of a small business corporation and the taxpayer finances the sale of property to his child who is a resident of Canada, then up to a 10 year reserve (averaging period) may be used. In order to qualify for the 10 year reserve, all the conditions that are required to qualify for a rollover must exist as provided for in subsections 73(3), (4), and (5) of the Income Tax Act. The maximum amount that may be claimed as a reserve is the lesser of the following two rules:

1. Rule of 1/10
$$\frac{10 - \text{No. of Years Since Sale}}{10} \times \text{Taxable Capital Gain}$$
or
2. Proceeds Rule
$$\frac{\text{Principal Unpaid}}{\text{Total Selling Price}} \times \text{Taxable Capital Gain}$$

Whatever reserve is claimed in one year must be brought into income the following year, however, a new reserve can be calculated for that year.

The following example illustrates the calculations for a 10 year reserve:

Father sells land to son for	$100,000
Adjusted cost base of land	20,000
Capital Gain	80,000
Taxable Capital Grain (1/2)	40,000

Terms of Agreement:
- $16,000 down
- Balance of $84,000 payable by way of principal payments of $6,000 per year for 14 years.

	Year 1	Year 2	Year 3
Beginning Principal	$100,000	$ 84,000	$ 78,000
Principal Paid	16,000	6,000	6,000
Principal Unpaid	$ 84,000	$ 78,000	$ 72,000

- Rule of 1/10

$\frac{10 - 1}{10} \times 40{,}000$ $\frac{10 - 2}{10} \times 40{,}000$ $\frac{10 - 3}{10} \times 40{,}000$

= $ 36,000 = $32,000 = $ 28,000

- Proceeds Rule

$\frac{84{,}000}{100{,}000} \times 40{,}000$ $\frac{78{,}000}{100{,}000} \times 40{,}000$ $\frac{72{,}000}{100{,}000} \times 40{,}000$

= $33,600 = $31,200 = $28,800

Reserve is

Capital Gain Calculation:			
Taxable Capital Gain (or Reserve Carried Forward)	$40,000	$33,600	$31,200
Reserve	33,600	31,200	28,000
Amount Taxed	$ 6,400	$ 2,400	$ 3,200

At the end of 10 years the full amount of taxable capital gain ($40,000) would have been reported as income.

In order to obtain the greatest averaging advantage, agreements for sale should be structured so that no single payment (including the down payment) in the first 10 years exceeds 1/10 of the total selling price.

Five Year Reserve
Up to a five year reserve may be used where capital property is sold, where all or a part of the price is financed by the seller and the seller is not eligible for a 10 year reserve.

The reserve calculations are similar to the example for the 10 year reserve except that the factor would be 1/5 of the selling price rather than 1/10.

Three Year Reserve
A three year reserve may be used where property is sold and the proceeds must be reported as income (100% taxable) rather than as capital gain. This reserve would not be relevant to most farm businesses.

Where an agreement for sale is used to average tax on capital gain, the agreement must not stipulate that the balance owing is payable on demand. Otherwise, a reserve may not be used and the capital gain must be added to the vendor's income in the year the

agreement is made. This differs from an agreement for sale of inventory, such as grain or livestock, where the tax on the sale can be averaged even if the agreement stipulates that the balance is payable on demand.

A reserve cannot be declared in the year of death. However, if the right to receive the proceeds are transferred to the deceased's spouse and the spouse and the legal representative of the deceased elect on Form T2069, then the reserve can be carried over to the spouse. Both the deceased and the deceased's spouse must have been residents of Canada on the date of death. With this election the spouse of the deceased may use reserves in the future in the same manner as if the deceased had lived.

Agreements for sale involving forgiveness of debt on installment payments should be avoided.

If the debt is settled without payment (written off, forgiven, gifted) the child will eventually be subject to income tax on the amount of debt that is written off. In addition, the interest portion of the payment that is forgiven will be considered income to the parent and an expense to the child even though money did not change hands. To avoid this problem the parent should make annual cash gifts (e.g. cheque and receipt) so that child can honour his commitments with cash under the agreement for sale.

Individuals planning to use agreements for sale for tax averaging should seek the advice of Revenue Canada, an accountant, or a Farm Management Specialist before proceeding. This is especially true with the introduction of the capital gains exemption.

One disadvantage of agreements for sale is that the sale funds are largely unavailable to the vendor. Therefore, they are most commonly used in family land transfers. This method of selling provides credit for a son who is beginning to farm and a tax saving investment for a father who is retiring.

(vi) Income Averaging Annuity Contracts
Income Averaging Annuity Contracts were eliminated in the Federal Budget of November 12, 1981. Taxpayers who purchased Income Averaging Annuity Contracts prior to November 12, 1981 are required to report the regular annuity payments received in the future under the old rules.

(vii) Single Premium Deferred Annuities
A single premium deferred annuity is a plan in which one fixed sum is invested initially and where benefits in the form of annuity payments begin at some stipulated future time (e.g. retirement age).

No tax deduction is permitted for the initial investment. Accrued interest earned by the annuity must be included in taxable income every three years. Single premium deferred annuities may be considered by individuals with high marginal tax rates at the time of payment of the single premium who believe that their marginal tax rate will decline.

(viii) General Averaging
The general averaging provision of the Income Tax Act that had been available to taxpayers since 1972 was eliminated at the end of 1981.

(ix) Five Year Block Averaging
Farmers whose chief source of income is derived from farming are permitted to average their income in five year blocks. It can be applied whether income is rising, falling, or stable from year to year.

The averaging period consists of the current year plus the latest four years of the previous six years for which tax returns were filed on time. If tax forms were not filed in any years because no tax was payable, the tax form(s) for those years can be filed before the tax filing deadline of the year of averaging and still qualify. Block averaging is not permitted in any year in which forward averaging is used to calculate tax.

No year included in a previous block average can be included in the current block average; therefore, the block average can be used at most only once every five years.

Five year block averaging is applied manually using a special tax form. The procedure for calculating a five year block average is outlined in the Farmer's Income tax Guide. Be certain to use the final tax figures shown on your notices of assessment (sent each year after you have filed tax) rather than the figures shown on your tax form. Also be careful that the block average saves you tax dollars. If your income tax rises at the same rate as the index applied to tax rates, you will have no tax saving. Five year block averaging is the most beneficial where your income is rising, falling or fluctuating greatly.

Prior to 1983, it was possible to claim the investment tax credit twice when a five year block average was applied. Doubling up will not be permitted for 1983 and subsequent taxation years.

(x) Forward Averaging
The forward averaging provision is effective for 1982 and subsequent years. It permits a taxpayer to transfer eligible income of the current year to future years which may result in tax savings. This provision is designed to replace general averaging and Income Averaging Annuity Contracts.

The amount of eligible income which is forward averaged in any one year is excluded from taxable income for the purposes of calculating regular income tax. The excluded eligible income is subject to taxation at the highest marginal tax rate excluding the

provincial surtax (56% in 1986). The excluded income is referred to as the "Accumulated Averaging Amount." The "Accumulated Averaging Amount" is indexed each year for inflation and is increased by eligible income forward averaged in subsequent years and is reduced by amounts brought back into income in future years.

The taxpayers may elect to bring into income in any year in the future all or any portion of the "Accumulated Averaging Amount." At that time, the portion of the "Accumulated Averaging Amount" added to income is taxed at the applicable tax rate and tax bracket for that year, but the taxpayer earns a tax credit equal to the highest marginal tax rate on that amount. If the taxpayer is in a lower tax bracket than when the eligible income was forward averaged, there will be a tax saving.

The amount of income that is eligible for forward averaging depends on the current year's net income, taxable income and type of income as well as the net income of the previous three years. The net income of the previous three years is adjusted by the indexing factors established for each year by Revenue Canada. These amounts are summed and divided by three to give an average for the three years. This amount is then increased by 10% (only current year's income in excess of 10% of the adjusted previous three year average may be forward averaged). This figure is referred to as "Adjusted Income." The "Adjusted Income" will be calculated automatically by Revenue Canada and will be indicated in the identification section of each taxpayer's personalized income tax return. The taxpayer may calculate the amount himself on the Forward Averaging Tax Calculation form (T540).

Subject to a minimum of $1,000, the amount that may be forward averaged is the lesser of the current year's net income minus the "Adjusted Income" or the taxable income for the year. For certain types of income, such as net capital gain, and the income earned by artists, entertainers and athletes, the full amount of such income may be forward averaged. For deceased taxpayers, the full amount of any income previously forward averaged must be reported as income in the final return but this amount may be taxable at a three year averaged rate.

To be eligible to apply the forward averaging provisions the taxpayer:

(a) must be a resident or "deemed" resident of Canada throughout the year of averaging plus the two immediately preceding years,

(b) must have income which is eligible for forward averaging,

(c) must pay all due taxes, interest and penalties within 30 days from the mailing date of the Notice of Assessment for the year of averaging,

(d) must have filed a return for each year in the "averaging period" for which tax was payable, and

(e) must make a valid election by completing form T540 and file it with the tax return by April 30.

The following example illustrates the use of forward averaging:

Assumptions:
- 10% inflation, tax rates and exemptions indexed
- Farmer has $70,000 of taxable capital gain over and above his $250,000 exemption
- He qualifies and elects to forward average $70,000

	Year 1	Year 2	Year 3
Regular Income	$25,000	$25,000	$25,000
Taxable Capital Gain	70,000		-
Net Income	$95,000	$25,000	$25,000
- Personal Exemptions	-8,000	-8,800	-9,680
- Amount Forward Averaged	-70,000	-	-
+ Forward Average Addition	+0	+10,000	+12,000
= Taxable Income	$17,000	$26,200	$27,320
Income Tax on Taxable Income	$ 4,806	$ 8,345	$ 8,795
+ Tax on Amount Forward Averaged (56% x $70,000)	39,200	-	-
- Refund on Tax (51.% of Forward Average Addition)	-	5,100	6,120
Total Tax	$44,006	$ 3,245	$ 2,675
Accumulated Averaging Amount Calculations			
Beginning Amount	$ -	$ 77,000	$78,700
+ Amount Forward Averaged	70,000	+0	+0
- Amount Added to Income	-	-10,000	-12,000
Balance	70,000	67,000	61,700
Accumulated Averaging Amount (Indexed 10%)	$77,000	$73,700	$67,870

Forward averaging may not be beneficial to taxpayers that do not have a portion of their taxable income falling into the top marginal tax rate since electing to forward average some income would result in more tax being paid immediately. For example, if a taxpayer's top marginal tax rate was 35% and he qualified and elected forward average, say, $10,000, there would be approximately $5,600 of tax paid immediately on that amount rather than approximately $3,500 as regular tax, an increase of $2,100. However, if the taxpayer was sure his income would decline and be in a lower tax bracket in one or two years, it may still pay to forward average.

Forward averaging should be beneficial to those taxpayers who are in the top marginal tax rate. Firstly, tax on eligible income forward averaged is at the slightly lower rate versus the regular top maximum marginal tax rate. (The provincial surtax of 12% on provincial tax in excess of $4,000 does not apply when calculating tax on the amount forward averaged.) In addition, if the tax is paid on the eligible income forward averaged, there will be further tax savings in the future if the taxpayer falls into a lower tax bracket.

VII. Tax Implications of Business Arrangements

1. Incorporated Farms

Farms incorporated as companies or co-operatives are for income tax purposes treated similar to individual persons in that they pay income taxes on their own behalf. However, they do not deduct the equivalent of "personal exemptions"; in effect, every dollar of an incorporated farm's net income is taxable.

Most farm corporations qualify for the "small business deduction" which reduces the tax rate to a flat 25%. This tax rate will decrease by 1987. This tax rate applies to the first $200,000 of "active business" net income per year. The cumulative limit of $l,000,000 which applied up to the end of 1984 will not apply after 1984.

The farm operator who has incorporated his farm must also file a personal income tax return. His income may be in the form of interest on debts owed to him by the corporation, wages from working for the corporation and dividends which reflect distribution of the corporation's after-tax profits. He owns the incorporated farm by virtue of money that it owes him and the shares he owns. As the net worth (assets minus liabilities) of the farm increases, so does the value of his shares. Thus, when he sells shares for their market value, he has a taxable capital gain.

Shares in a family farm corporation may be rolled over from a parent to a child under certain conditions without generating a capital gain. A family farm corporation is a corporation that carries on the business of farming in Canada, it uses most of its property in the business of farming in which the share owner, his spouse or one of his children are actively engaged. It is Revenue Canada's position that the corporation must use at least 90% of its assets in farming to qualify. A child includes a grandchild, great-grandchild, a daughter-in-law or son-in-law, illegitimate children, legally adopted children, step-children and foster children.

Incorporated farms may file tax returns on the cash method. Therefore, much of the information in this *bulletin is* applicable to corporate farm tax credit planning. Further information on tax strategies for incorporated farms is included in the bulletin, "Farm Incorporation", available from the Saskatchewan Department of Agriculture.

2. Partnerships

Like incorporated farms, partnerships are considered to be the same as a private citizen. However, they do not pay tax on their own behalf. Rather, the income of the partnership after deducting expenses and capital cost allowance, is divided among the partners according to their partnership agreement.

Ownership interest in a partnership is treated similar to a bank account. Records of investments in the partnership and cash withdrawals must be maintained to determine how much a particular partner owns at any one time. Ownership interest in a partnership can increase in value and is subject to capital gains taxation. The capital gain can be deferred if the partnership interest is rolled to children at or below its adjusted cost base.

3. Other Farm Operating Arrangements

Farm operating agreements, joint ventures, machinery sharing agreements and machinery-labour sharing agreements vary from arrangement to arrangement. This depends upon whether only assets or both expenses and income are shared, and whether assets are owned individually or jointly.

When both income and expenses are shared, as in a farm operating agreement, the income of the operators is usually calculated in the same manner as a partnership. If only expenses are shared, as in a machinery sharing agreement, each individual simply enters his share of the joint expenses on the expense side of his own farm income and expense form.

If operators own machinery individually, capital cost allowance is deducted after the individuals split off their individual shares of income and expenses. Jointly owned machinery can be handled in one of two ways:

(i) Capital cost allowance can be deducted before the net income is calculated and divided between the individual operators.

(ii) Each operator deducts capital cost allowance on his share of each machine.

The second approach is more flexible because each operator can decide for himself how much capital cost allowance he should claim.

4. Leases

Cash rent payments are income to the landlord and a deductible expense for the tenant. Crop share payments are income to the landlord but are not a deductible expense for the tenant unless he has reported all of the crop income before the payment of the crop share.

A tenant can deduct expenses he incurs in maintaining and repairing the property he rents. Where a tenant pays for improvements to the rented property, he can claim the expense or capital cost allowance. He would be subject to recaptured capital cost allowance or capital gain if he is paid later for the improvement.

A landlord can deduct capital cost allowance for improvements made for rental property. He can also declare as expenses the costs of maintenance and repairs paid by him.

Income to the landlord from a crop share agreement is treated like farm income for the purposes of a five year block average. The landlord is eligible for block averaging only if his income from farming plus the crop share lease exceeds his other income over the five year averaging period.

When a tenant pays rent to a landlord who is not a Canadian resident he must deduct a withholding tax and send it to Revenue Canada.

5. Custom Farming Agreements

Frequently, a landlord wishes to remain classified as a farmer and retain close control of the farming business but not be actively involved in its operation. A custom farming agreement may accomplish this objective.

A farmer, but not a landlord, is able to make contributions to the Western Grain Stabilization Plan and to the Canada Pension Plan on earnings from the farm business.

The custom operator in a custom farming agreement does not have the same rights as a tenant in a land leasing agreement. A custom farming agreement is not an interest in land. Consequently, a caveat can not be placed against the owner's title to protect the custom operator's interest, or to warn third parties of its existence. If the owner sold the land covered by a custom farming agreement to a third party who was unaware of it, the custom operator would have to sue the original owner for contractual damages and would have no right to continue farming the land.

Preservation of Capital Gain Rollover Provisions

Land may be rolled over on a tax deferred basis when it is transferred from a parent to a child, providing the child is a resident of Canada and the land is "used in the business of farming" by the parent, his spouse or any of his children immediately prior to the transfer.

Farm land leased by a taxpayer to his spouse, a child, to his family farm corporation or to his spouse's or a child's family farm corporation or partnership, now qualify for a rollover. Land leased in any other fashion will not qualify for a rollover.

For a rollover of capital gain to occur on a property exchange, the land must be "used in the business of farming" by the owner. Land leased to anyone would prevent a property exchange rollover from occurring.

Also, land which is custom farmed is eligible for the immediate $500,000 capital gains exemption. Land which is rented and has never been farmed by the land owner, spouse or their child, falls under the phase in provision. Therefore, in 1986, only $50,000 of the capital gain would be sheltered.

In a properly structured custom farming agreement, the land will be considered to be "used in the business of farming" as opposed to being a rental property as in a lease agreement. Revenue Canada's Interpretation Bulletin #349R, "Transfer of farm property to child on death" indicates that a farm owner may engage the services of another person to undertake virtually all of the work associated with his farming activities (custom working). However, the owner of the farm property should assume some risk and provide the management for the operation.

To be at risk, the farm owner should pay some of the operating costs and stand to lose money if there was a crop failure. His management should take the form of decision making responsibilities for such functions as determining crops and varieties to be grown, fields to be seeded and fallowed, timing of field operations, inputs to be used and dates of crop sales.

In using custom farming agreements, it is important that the actual relationship that exists between the landowner and the custom operator conforms to the agreement. Revenue Canada will look at the actual facts of the situation and not only the agreement if there are discrepancies between an agreement and the facts of the situation.

Landowners should consider documenting their decision making responsibilities by way of copies of letters of instruction or minutes of meetings.

Custom Farming Agreement Forms

There are many variations to custom farming agreements. However, three general categories of arrangements exist. These are:

(a) Custom Hiring Agreement
The landowner (farmer) makes all the farming decisions, arranges for and pays for the purchase of all inputs and receives all the income from grain sales. The landowner and the custom operator agree to have the custom operator perform all machine operations. The landowner agrees to pay a custom fee to the custom operator upon the completion of each machine operation.

A variation to the above is for the landowner to pay the custom operator a basic lump sum fee by a

certain date, say July 31, of each year plus a bonus after the final accounting is completed for the year. The bonus could be a percentage, say 50% of "net income." "Net Income" would be the value of all crop sales attributed to the year minus the costs for custom work, seed, fertilizer, chemicals and property taxes. The bonus percentage amount should depend on the size of the basic lump sum fee in relation to custom rates in the area.

(b) Joint Farming Venture Agreement
In this agreement, both parties are considered to be farmers. The landowner supplies land to the joint venture and the other party supplies machinery, machinery operating costs and labor.

The two parties then share the crop sales on a percentage basis, say, 50:50, and also share the input costs (seed, fertilizer, chemicals, crop insurance and property taxes) on the same basis.

(c) Farming Partnership Agreement
The agreement is much the same as in the joint venture, except that a partnership is established with more defined rules to govern the relationship.

Some custom farm agreements have been drafted in a manner that gives the same financial results and exposure to risk as a crop share lease. A common agreement is one where the landowner (the "farmer") takes out the Canadian Wheat Board permit book in his name. All the crop is sold in the "farmer's" name. After each grain sale or CWB payment is received, the "farmer" pays cash equal to, say, two-thirds of the income received to the custom operator. The custom operator supplies seed, fertilizer, chemicals, machinery, labor and machinery operating costs. It is quite evident that it is the same as a crop share lease. Revenue Canada is very likely to look at these agreements as leases. Therefore, the landowner would not qualify for a capital gain rollover to his child or a rollover on a property exchange.

Consult a lawyer, accountant or farm management specialist before entering into any custom farming agreement since some agreements may not meet the "used in the business of farming" criteria. Review custom farming agreements that were entered into several years ago to determine if they are in tune with current requirements.

VIII. Saskatchewan Tax Incentives

1. Livestock Investment Tax Credit Program

The Livestock Tax Credit provides a tax credit to investors who feed livestock in Saskatchewan and market these animals for slaughter. The tax credits are $25.00 per head of slaughter cattle, $3.00 per head of slaughter hogs and $2.00 per head of slaughter lambs. All Saskatchewan residents, whether farmers or not, are eligible to participate in the program. This includes individuals, partnerships, co-operatives and corporations. The livestock must be fed for a minimum period in Saskatchewan and be sold for slaughter in Saskatchewan or out-of-province at a federally inspected packing plant between March 22, 1984 and December 31, 1987.

The tax credit is applied against Saskatchewan tax payable and it must be utilized in the year in which it is issued. A livestock tax credit earned which exceeds net Saskatchewan tax payable in a year may be carried forward for a maximum of seven years.

Further information and application forms for the Livestock Investment Tax Credit program are available from:

Livestock Investment Tax Credit Program
Saskatchewan Agriculture
Room 329, 3085 Albert Street
Regina, Saskatchewan S4S 0B1
Phone: 787-5957

2. Venture Capital Program

The Venture Capital Program is intended to stimulate the growth of Saskatchewan's small business sector. A single investor, or a group of investors, can pool their capital and form a Venture Capital Corporation. Such investors are eligible to receive a tax credit equal to 30 percent of their investment in a Venture Capital Corporation. The tax credit is used to reduce Saskatchewan tax payable in the current year. Unused tax credits may be carried forward for up to seven years.

A Venture Capital Corporation must invest its capital in equity shares of eligible small businesses in Saskatchewan.

Further information is available from:

Saskatchewan Tourism and Small Business
5th Floor, Bank of Montreal Building
2103 - 11th Avenue
Regina, Saskatchewan S4P 3V7
Phone: 787-3524

3. Livestock Facilities Tax Credit Program

In the March 25, 1986 provincial budget, the Saskatchewan Government introduced a 15 percent tax credit on construction of new livestock facilities or renovation to existing facilities. The facility must be used solely in the livestock business. The tax credit can be used to reduce your provincial tax payable. Any unused portion can be carried forward for seven years. This program is retroactive to January 1, 1986 and will terminate December 31, 1989. Application must be made within six months of the end of your taxation year.

Further information and application forms for the Livestock Facilities Tax Credit Program are available from:

Livestock Facilities Tax Credit Program
Saskatchewan Agriculture
Room 329, 3085 Albert Street
Regina, Saskatchewan S4S 0B1
Phone: 787-5957

4. Stock Saving Plan

The Stock Saving Plan is designed to encourage investment by Saskatchewan residents in Saskatchewan business. Eligible investment will be newly issued trasury shared in qualifying corporations. The corporation must trade their shares on a Canadian stock exchange and pay at least 25 percent of their total wages to employees in Saskatchewan.

For further information contact:

Saskatchewan Revenue and Financial Services
3rd Floor, 2350 Albert Street
Regina, Saskatchewan S4P 4A6
Phone: 787-6690

IX. Special Tax Situations (for farmers using the cash method)

(a) Income Items:

1. Canadian Wheat Board Cash Advances
The Canadian Wheat Board cash advances are no longer considered taxable income in the year they are received. The cash advance is considered for tax purposes, an interest free loan and is not taxable until the loan is repaid. Therefore, when a farmer delivers grain the gross amount of the sale (before the deduction to repay the cash advance) should be reported as income.

2. Deferred and Final Payments
Deferred cash tickets are taxable in the year received. This is the case even though a percentage of the deferred cash ticket is used to repay the cash advance. Cash tickets are taxable in the year that the cash ticket is issued. When grain is delivered and a storage ticket is received no amount is taxable at that time. Final payments are taxable in the year they are received.

3. Futures Market

Profit made from hedging or speculating in commodities produced by the farmer on the futures or commodity market, is considered to be farming income and is taxable. Income from speculating on any commodity not produced by the farmer is treated as a capital gain.

4. Stabilization and Subsidy Payments
Any government payments from a program to increase farm receipts such as the Western Grain Stabilization Plan or livestock stabilization programs or a milk subsidy is taxable income.

5. Grants
The taxability of grants depends on the use of the funds. If a grant is given to reduce the cost of a capital asset then the cost of the asset must also be reduced by that amount when entered on the capital cost allowance schedule or when determining its cost for capital gains purposes. If the grant is given to reduce the cost of operation (e.g. livestock purchase) the grant is taxable income and the total expense is entered, or the purchase price of the livestock minus the grant is entered as an expense.

6. Patronage Payments
Patronage payments credited to a member of a cooperative except for the portion that relates to personal expenditures are taxable income, whether received in cash or deferred. If a withholding tax is deducted, it is an advance payment of income tax; use it as a credit when filing your tax return. When the deferred portion of the payment is received it is not taxed.

7. Insurance Benefits
Crop or Hail - all proceeds are taxable income (you have the option of deferring crop insurance payments)

Livestock - all proceeds are taxable

Equipment and Buildings - treated as capital sale proceeds
- Part XVII: could result in capital gains
- Part XI: could result in recaptured capital cost allowance or capital gains

Accident - all taxable income if premiums were deductible, otherwise not taxable.

Life - not taxable

Unemployment - taxable income

8. Forced Destruction of Livestock
Income from the forced destruction of livestock under government authority (e.g. health of animals) can at the option of the farmer be claimed as taxable income in the year following the year of forced destruction.

9. Expropriation of Property
When land is expropriated, the price paid for the land is handled in the same way as the sale of any land (see "Sale of Part of Property," Section IV). Additional funds received from crop damage, etc. is business income.

10. Easements
Income from easements such as pipelines, power lines, or oil wells is subject to capital gains. (see "Sale of Property," Section IV.)

11. Oil and Mineral Leases
Rent and crop damage payments on oil and and mineral leases are taxable income.

12. Sale of Buildings
The sale of buildings is treated the same as the sale of machinery. These should be itemized separately from the land in the sale agreement. If a part XVII building has had a part XI addition, itemize the addition separate from the building. In this case there may be recapture of capital cost allowance on the addition but not the original building.

13. Trading Grain or Livestock for Capital Assets
If produce such as grain, feed, or livestock is exchanged on account of the purchase price of an asset, then the value of the produce must be reported as income and an equivalent value reported as the capital cost of the asset.

14. Using Home-Grown Produce
The cost of producing saleable produce (e.g. meat, vegetables, milk, eggs) which is consumed on the farm, is income if the expense of producing that produce is claimed.

15. Custom Work
Custom work income is all taxable in the year received.

16. Accounts Receivable
If grain, feed or livestock are sold by way of an agreement for sale, the income is claimed only when received.

17. 4-H Calves and Other Sales by Children
The sale of 4-H calf is technically income. If a parent wishes to pay his children, he is better to pay them cash wages than to pay them in kind.

18. Rebates
For a number of years rebates received directly from the manufacturer, when an asset was purchased, was considered a gift allowing farmers to claim the Business Investment Tax Credit on the full cost of the asset. However, provisions were introduced in the May 23, 1985 Federal Budget making it necessary to reduce the asset value by the amount of the reimbursement before the tax credit or capital cost allowance is claimed.

19. Deferred Livestock Sales
Revenue Canada has indicated that people who want to defer their livestock sales may now do so. A farmer can sell his livestock and receive payment in the form of a post-dated cheque and meet the requirement of Revenue Canada. The buyer, however, cannot use the livestock as an expense until the cheque has cleared. Also, Revenue Canada will not accept deferral on livestock sales when payment is by a certified post-dated cheque. This tax strategy should be used with caution.

B. Expenses and Capital Cost Allowance
When claiming any expense against farming income claim only those amounts actually spent to earn farm income.

1. Clearing and Breaking
The cost of clearing and breaking land can all be used as a deductible expense in one year. See "Adjustments for Clearing and Breaking," Section IV, for calculation of adjusted cost base of land where clearing and breaking has taken place.

2. Dugouts, Wells, Water And Sewage Systems
Dugout construction is a capital cost. It is entered in Tax class 6.

The cost of drilling, testing or digging a water well can be claimed as an expense. However, the casing and cribwork must be capitalized. The cost of a water distribution system, including the pump and its installation, the piping and the trenching must be capitalized, also.

The costs of a water and sewage system is treated as a capital expense. If the system is for the house only, then 1/4 of the total equipment and construction costs would be permitted as the business portion. However, if the system is for more than the house, the cost of the house plumbing and outdoor sewage plus $200 is considered house improvement with 1/4 eligible for capital cost allowance. The balance of the water system, including the pressure system, would be eligible for capital cost allowance in Tax class 8.

3. Road Construction
Unpaved road construction costs incurred on the farm can be claimed as operating expenses. A paved road is considered to be a capital cost. It is depreciated in Class 1 (4%) if completed before May 25, 1976, and in Class 17 (8%) after May 25, 1976.

4. Custom Work
Any machine rental, custom work or contract labor associated with the farm business such as baling, combining, stone picking or trucking, can be deducted as an operating expense.

5. Room and Board for Hired Labor
A reasonable amount for room and board for hired labour may be deducted as an expense in addition to wages paid. If this is done, an equal amount must be shown on the employee's T4 slip and reported by him.

6. Tools
Tools under $200 should be placed in tax class 12 with a maximum capital cost allowance rate of 100%. Tools over $200 should be placed in Class 8. Beginning farmers may find this helpful to delay deduction of the cost of the tools. Also tools following into Class 12 are not subject to the half-rate rule.

7. Unusually High Repairs
High repair costs are deducted as an expense rather than adding the cost to the capital cost allowance schedule. Repairs may only be added to the capital cost allowance schedule when a machine is purchased, a high repair cost is incurred immediately

after the purchase and the purchaser knew at the time of purchase that repairs were required.

8. Deductions from Income Source
Deductions such as Western Grain Stabilization levies, or marketing and yardage charges for livestock are deductible expenses. If you claim these expenses be sure to report the total income before they were deducted, not the net amount received.

9. Legal and Accounting Fees
Legal, appraisal and accounting fees associated with buying land or equipment are added to the capital cost of the asset. In effect they do not become deductible until the asset is sold. The cost of moving a building is treated in the same way. Annual accounting and legal fees for farm management and income tax purposes are deductible.

10. Insurance
Any insurance premium directly related to a business asset is deductible. This would include crop, hail, livestock, and fire insurance, except for the personal portion of house or car insurance.

11. Vehicles
All transportation expenses directly related to the business of farming can be deducted. Usually, all truck expenses and up to two-thirds of car expenses are deductible. These vary with actual use and whether or not you live on your farm. If you do not own a car, some of your truck expenses will be considered personal. A station wagon is considered to be a car. You should be able to prove that the amount deductible is a reasonable estimate of the business use.

A reasonable portion of recreational vehicle expenses may be deducted if used for business purposes. For example, if a snowmobile is used to check on livestock or granaries as well as for recreation, some expense may be claimed for the business.

12. Conventions and Business Travel
A reasonable amount of the expenses can be deducted as a business expense for business travel and up to two conventions per year. Eligible expenses include travel, registration fees, meals and lodging. Obtain receipts.

13. Other Personally Related Expenses
Traffic fines, automobile association memberships and driver's licences are only deductible if definitely related to the business.

Life, medical and accident insurance premiums, except that required for a farm loan or for an employee, is a personal expense and not deductible.

A reasonable portion of power, heating and telephone costs for the house can be claimed as a deductible expense.

One-quarter of house repairs and capital costs, are generally allowed unless special circumstances exist. There is no allowance if the house is located off the farm.

The business portion of office equipment and supplies (e.g. calculators, stamps, desk, paper) can be deducted.

14. Canada Pension Plan Contributions
Canada Pension Plan contributions are based on earned income. This does not include investment, rental or annuity income. If you are an older farmer, you should consider contributing the maximum amount to receive maximum benefits upon retirement.

The maximum contribution each year is 3.6% of "earnings subject to contribution". The contribution is deductible from taxable income.

15. Home-Made Buildings and Equipment
When constructing a building or making equipment, the capital cost of the asset is the total cost of purchased materials plus the cost of hired labour. You cannot add an allowance for unpaid labour.

C. Family

1. Transfers to Minor Children or Spouse

The "attribution rule" affects transfer of property to spouses and children younger than 18. This rule states that when property is transferred to minor children or a spouse, the income from that "property" (interest, dividends, capital gains, rental) is taxed as income of the original owner. However, if the child or spouse used the property in a business (e.g. farming), the "attribution rule" does not apply and the child or spouse would report the business income as their own.

2. "Splitting Income" with a Spouse
Income splitting between spouses usually results in a lower total income Tax payable. Farm income cannot be split between a husband and wife unless they operate separate farm businesses, have a partnership agreement or both spouses have contributed assets or labour to the farm business. Assets contributed must have been obtained outside marriage, such as from a job, inheritance or credit from an outside source.

If your spouse does not have taxable income than you might consider lending funds on a bona fide loan arrangement. Your spouse may invest the funds to earn income and declare the amount earned as taxable income. To ensure that the loan is bona fide, it should be documented in writing. The loan may be repayable on the basis of a fixed repayment schedule or on a demand basis. There has to be interest charged as the attribution rule applies to low or no interest loans. Attribution Income = Earned Income - Interest Paid.

3. Wages to a Spouse
Beginning with the 1980 taxation year farmers may pay a wage to their spouse and deduct the amount paid as a farm expense.

The amount paid must be reasonable taking into account the time and type of work that the spouse spends in the farm business. Work such as answering business phone calls, buying parts and farm supplies, secretarial services, accounting and management decision making are among the duties that relate to the farm business.

Wages may be paid on a regular basis or on an annual basis. The person paying the wages must obtain an employer's number from Revenue Canada and remit the required amounts for Canada Pension Plan and Income Tax. No Unemployment Insurance Commission deductions may be made.

This provision permits income splitting between husband and wife which would reduce the overall level of Income Tax payable. It also permits the spouse of the farmer to contribute to the Canada Pension Plan and be eligible for pension benefits.

4. Husband-Wife Farm Partnerships
An alternative to paying a wage to a spouse is to form a husband-wife partnership for the farm business, thereby permitting each party to receive a share of the farm's profits (losses).

As long as one's spouse contributes capital and/or labor, and management then a partnership can be justified. A partnership may be more advantageous than paying a wage to a spouse if the spouse's capital contribution is significant. The division of income between the husband and wife should be reasonable given their respective contribution of capital and labour to the partnership.

Capital contributed must in fact belong to the spouse making the contribution. Capital given by the spouse to the other is really capital of the giver. (See No. 2 above - "Splitting Income" with a spouse.)

5. Wages to Children
Wages to children can be deducted if:
(i) the wages were actually paid
(ii) the services were for the production of income
(iii) help would otherwise have to hired
(iv) the wages are reasonable considering the child's age and type of work.

It is best to pay the child by cheque as evidence of payment. However, if the child is paid in the form of feed or livestock the parent may deduct the value as an expense providing that the child reports the value of the feed or livestock as income. The value of board and lodging provided for a dependent child cannot be deducted as an expense. If the wages are over $250 per year, a T4 slip must be issued.

6. Family Allowance
The parent claiming a child as a dependent must also declare the family allowance as income. Where a family contains more than one child, the parents can "split" the family for the purpose of claiming exemptions, each declaring family allowance income and deducting the tax credit for those children they claim.

7. Child Tax Credit
A Child Tax Credit is available to individuals for children eligible to receive the family allowance.

In most cases only the mother of the eligible children may apply for the tax credit. This means that she must file an income tax return even if she does not have taxable income. Effective for 1986 a prepayment of $300 per child will be made in November if the eligible claimants family income is $15,000 or less.

D. Deductions and Exemptions

1. Interest and Dividends
This deduction allows a taxpayer to receive up to $1,000 of tax-free income per year from:

(i) interest from Canadian sources
(ii) dividends from taxable Canadian corporations

Interest paid to earn the above income is deductible as an expense, but the interest and dividends deduction only applies to qualifying income over and above the interest paid.

The deduction does not apply to interest and dividends received from relatives or from a corporation owned by the taxpayer, or to patronage payments.

2. Age Exemptions
Taxpayers 65 years old or older may deduct an age exemption when calculating taxable income.

3. Pension Income Deduction
A taxpayer can receive up to $1,000 in qualifying pension income tax-free by using the pension income deduction. If the taxpayer is age 60 or older, periodic or lump sum payments from a pension plan qualify. If the individual is 65 years or older, annuity payments from registered retirement savings plans qualify for the Pension Income Deduction. Canada Pension Plan and Old Age Security payments are not eligible.

4. Education Deduction
Full-time students at college, university or technical school can deduct $50 per month of enrollment as well as deducting their tuition expenses. The $50 deduction does not apply if the student was paid to attend. This deduction may be claimed by a supporting parent providing that the student's taxable income is zero or less.

5. Transfer of Deductions and Exemptions
If a taxpayer's spouse is eligible for certain deductions but unable to deduct them because he/she has no taxable income, the taxpayer may be able to transfer the unused portion to his/her form. The eligible deductions include age exemption; interest dividends deductio[illegible]nsion income deduction; education deductic[illegible]and a deduction allowed for blind or disabled people. If the spouse has a taxable income or is claiming a refund of taxes, he/she must file a return on his/her behalf. However, the unused portion of his/her deductions can still be used by his/her spouse. A taxpayer can also use the unused portion of the education deduction of dependent children.

E. Miscellaneous

1. Quotas and Licences
Government rights, quotas and licences and other intangible assets necessary to produce income, are called "eligible capital expenditures" for tax purposes. There are special tax rules for writing off the cost of eligible capital expenditures and for handling the proceeds when they are sold. They do not qualify for the capital gains exemption. See the Farmer's Income Tax Guide for more information

2. Basic Herd
Many farmers with cattle, horses, sheep or swine established "basic herds" before 1972. Additions to the basic herd were non-deductible and reductions were non-taxable. Thus, farmers could establish or disperse their herds without extreme expenses or income in any particular year. The Optional Inclusion of Value of Livestock on Hand (Section VI) now accomplishes much the same purpose.

Since 1971, a basic herd can no longer be set up. However, an existing basic herd can be reduced and the reductions claimed as deductions. Each year the amount deductible from income equals the least of the average valuation day value per head of:
i) the number of animals in the class disposed of in the year
ii) 10% of the basic herd at V-day
iii) the number of animals in the basic herd in the previous year

Deduction for Basic Herd Reduction equals Number of Animals by Which Basic Herd Reduced times Average Value of Animals in that Class at V-Day

3. Debtors Gain
If all or part of an existing debt, payment or obligation is forgiven (cancelled, settled, written off), the person who owed that debt must report the forgiven amount as "debtor's gain." This is applied in the following order, to reduce any existing:

(i) non-capital losses (e.g. farm losses)
(ii) net capital losses
(iii) restricted farm losses.

Any remaining portion of the gain is deducted from his undepreciated capital cost of depreciable property or his adjusted cost base of land and other property. In effect, the gain eventually becomes taxable to the debtor.

Farmers are most likely to encounter problems with debtor's gain when attempting to gift assets to their children. To avoid these problems, do not gift by way of forgiving a debt; gift cash. Be certain that all debts and obligations are paid.

4. Non-Residents
The rules for taxation of non-residents are complex. In part they depend on:

(i) the taxpayer's circumstances—whether or not he is by definition a non resident.
(ii) his type of income—employment, business or investment.
(iii) the country he resides in—different countries have different Tax treaties with Canada.

In general, a non-resident's income from employment is taxed similar to that of a resident Canadian. However, income from property such as rent, pension, interest and dividends are subject to a non-resident withholding tax. This tax is refundable when the non-resident files his return in Canada.

Contact Revenue Canada for further information

5. Income Tax at Death
When someone dies, the estate must file a tax return for the year up to the date of death. This return must be filed by April 30 of the following year or 6 months after date of death, whichever comes last. This return includes all regular income for the year, capital gains less capital losses, recaptured capital cost allowance, and the value of "rights and things" such as grain, livestock, feed, unclipped bond coupons and dividends declared but not received at the time of death.

As well the deceased is assumed to have disposed of all his property immediately before his death. The various assets are transferred according to the terms of the will or, if there is no will, the Intestate Succession Act. Transfers of farming assets to children and any transfer to a spouse can qualify as rollovers. Rollovers must take place within 15 months of the date of death. In other transfers, capital gains and capital cost allowance recapture may occur.

See the bulletin, Estate Planning for Farm Families for further information on income tax at death.

6. Option to Buy
An option to buy clause in a will, lease, partnership or other agreement gives a specified individual the first opportunity to purchase a property under certain conditions. For example, on the death of one member of a partnership or father-son joint venture, the

survivor is given the first opportunity to purchase the assets of the deceased. Similarly, a son could be given the right upon his father's death to purchase land he leased from his father.

An option to buy between a parent and child may be used to assure a child that he has the first right to acquire the property but allows the parent to control the property while living. The time period in which to exercise the option should be sufficient to arrange financing.

The price in an option may be a specific amount, based on a formula or be the fair market value at the time the option is exercised. However, if something other than a fixed amount is specified, there is a possibility of a dispute arising about establishing a value.

If the parents intend to transfer the property at their death to a child and use a capital gain rollover, an option to buy in a will can now be used. In such a case, a rollover is not permitted as long as the land was used in the business of farming prior to the death, by the farmers, the spouse or the child, the child is a Canadian resident, and the property vests indefeasibly within 36 months.

7. Conditional Bequest
A conditional bequest included in a will may give a farming child the right to assume ownership of the farming assets providing that the child pays a stipulated amount to either the estate or to the other beneficiaries. A capital gain rollover will apply providing that no mention is made that the money paid is for any particular property. The amount paid in no way affects the adjusted cost base of the property.

Example clause in a will:
"I give the SW 16-40-40-W2 to my son James on the condition that prior to receiving clear title to the land that he pay $20,000 to my daughter Joan."

In this case the land would be rolled over to the child at the farmer's adjusted cost base. The child cannot use the cash amount paid or payable to increase the adjusted cost base. This fact would be a concern to the child making the cash payment since if the amount paid was in excess of the adjusted cost base of the land, no increase in the adjusted cost base to the child occurs.

Seek competent legal and accounting advice before including a "conditional bequest" clause in your will. Many factors must be considered to ensure that the property will qualify for the rollover. For example, the property must vest indefeasibly within 36 months of the death of the transferor. A conditional bequest clause may indicate that a mortgage or other charge may be placed on the land in order to provide funds to satisfy cash bequests to other beneficiaries. However, if the will states that the child who receives the land must make payments to other beneficiaries over time the land will not vest indefeasibly in the child unless payments are made within 36 months of the parent's death.

8. Lease Option Purchases
Property may be leased under a contract that gives the lessee an option to buy the leased asset. The exercise of such an option at a value less than its fair market value after December 11, 1979 will result in recaptured capital cost allowance when the asset is eventually sold.

When an option on leased property is exercised the deemed cost is equal to the lesser of either the fair market value of the property at the time that the option is exercised or the sum of the actual cost plus all rental payments made. The difference between the deemed cost and actual cost is considered to be capital cost allowance previously claimed. Recaptured capital cost allowance will be realized when the property is eventually sold.

Example:

A tractor valued at $70,000 is leased for five years at an annual rental of $15,000. At the end of five years an option to purchase is exercised at a cost of $20,000. The fair market value of the tractor at that time is $80,000. The tractor is sold some time later for $90,000. The deemed cost is the lesser of:
(a) fair market value at the date the option is exercised $80,000

or

(b) Actual cost plus rental payments (20,000 + 75,000) = $95,000

Actual Cost $20,000
Deemed Capital Cost Allowance Claimed (80,000 - 20,000) = $60,000
Capital Gain on Sale = 90,000 - 80,000 = $10,000
Recaptured Capital Cost Allowance on Sale = 80,000 - 20,000 = $60,000

This provision in the Income Tax Act applies to both depreciable and non-depreciable assets. For example, if an option to buy is exercised at a value less than its fair market value on farm land that was leased, recaptured capital cost allowance will occur when the land is sold.

Dividend Tax Credit

9. Dividends received from taxable Canadian Corporations qualify for a dividend tax credit when the taxpayer calculates income tax on the dividends received.

Effective January 1, 1987 a number of changes for handling dividends will come into effect. The corporate distribution tax will be dropped, the dividend tax credit will be reduced to 16 2/3 and the gross up will be reduced to a third.

The following example illustrates how the dividend tax credit applied:

Dividends (received in cash)	$100.00
Gross Up Amount (50% of dividends)	50.00
Taxable Amount of Dividends	$150.00
Federal Tax (25% rate)	37.50
Less: Dividend Tax Credit (22.67% of Taxable Amount of Dividends	34.00
Basic Federal Tax	$ 3.50
Provincial Tax (51% of Basic Federal Tax)	1.79
Total Tax Payable	$ 5.29
After Tax Earnings ($100.00 - $5.29)	$ 94.71

Dividends may return a greater after tax level of earnings than interest because dividend income is subject to more favourable tax treatment. The table below shows the relative rate of earnings for dividends and interest to give the same after tax earnings.

Dividend Yield	2%	4%	6%	8%	10%	12%
Equivalent Interest Yield	2.7	5.5	8.3	11.0	13.8	16.6

Example: On an after-tax basis a stock yielding 6% is equivalent to a term deposit yielding about 8.0%.

10. Saskatchewan Pension Plan
The Saskatchewan Government has introduced a pension plan for Saskatchewan homemakers, part-time workers, self-employed people and employees of small businesses. The plan is voluntary for residents of Saskatchewan between the ages of 18 and 65 years. Contributions will be accepted by December 31, 1986.

For more information on the Saskatchewan Pension Plan contact:

Saskatchewan Pension Plan
P.O. Box 5555
Regina, Saskatchewan S4S 9Z9
Phone: 1-800-667-7153

IX. Timing Tax Decisions

1. By December 31
- Keep records up to date during the year so that an approximate taxable income can be calculated at any time.
- Income must be received in the year to be an eligible addition.
- Any wages, including family wages, must be paid out to be an eligible expense.
- A machinery purchase contract must be signed to be eligible for capital cost allowance and a serial number for a new machine must be obtained to be eligible for the investment Tax credit.
- Income Tax installment payments are due by December 31.
- If you are not going to complete your own Tax return, see your accountant before the year end to:

(i) Ask questions on Tax strategies to use during the year
(ii) Determine what information is required and by what date you must present it to him.

2. Before March 1
You have 60 days from the end of the year to contribute to a Registered Retirement Savings Plan. Do not wait until the last day to look for the best plan. Shop around to get the best deal.

Contact your accountant to ensure that he has all the information required to complete your Tax return on time.

3. By April 30
You must file your Tax return and enclose a cheque for the balance of Tax payable for the year. When completing the Tax return, several deferral methods may still be available.

Consider:
- capital cost allowance
- losses carried forward from past years
- investment Tax credit available from present and past years
- the Optional Inclusion of Value of Livestock on Hand
- basic herd reduction
- 5 year block average
- forward averaging

Since personal exemptions and some deductions can only be used for the present year, calculate a tentative taxable income using all of the compulsory items. Then adjust this figure using other provisions to arrive at the most beneficial income level considering your income, long term business prospects and objectives.

X. Information and Services Available to Farmers

1. Saskatchewan Department of Agriculture
Provides free bulletins and counselling to the public on income Tax, estate planning, and other related areas. Bulletins are available from Ag. Rep. offices, and other Saskatchewan Department of Agriculture offices. Offers courses on taxation in local farm communities.

Farm Management Section
Room 329, Walter Scott Building
Regina, Sask. S4S 0B1
Phone: 787-5965

Regional Farm Management Specialists:

105 Provincial Office Building
North Battleford, Sask. S9A 3G7
Phone: 446-6146

Box 1690, Main Street
Kindersley, Sask. S9H 4G3
Phone: 463-2696

350 Cheadle Street West
Swift Current, Sask. S9H 4G3
Phone: 773-2866
110 Souris Avenue
Souris Valley Hospital Grounds

Weyburn, Sask. S4H 2Z9
Phone: 842-4607

Provincial Building
Yorkton, Sask. S3N 2Y4
Phone: 783-9743

Box 1480
Tisdale, Sask. S0E 1T0
Phone: 873-2693

2. Revenue Canada
Provides free booklets and information circulars on many income tax topics. Common publications include the "Farmer's Income Tax Guide" and "Income Tax Guide" which are sent to farmers each year. Other booklets are available at the district taxation office.

- Information available from district taxation offices
- Appeal Procedures:
  (i) Notice of Objection (Form T400A) must be filed within 90 days from mailing of the Notice of Assessment if the taxpayer disagrees with the Notice of Assessment or Reassessment.
  (ii) Tax Court of Canada - A taxpayer may appeal to this Court if the objection is not allowed.
  (iii) Federal Court of Canada - Taxpayers can appeal to the Federal Court of Canada, Tax Division, followed by the Federal Court of Canada, Appeal Division, and as a last appeal to the Supreme Court of Canada.
  (iv) Advance Rulings - These can be obtained by the payment of a fee. The rulings may be advantageous to a taxpayer when considering an unusual business transaction with major Tax implications.

District Taxation Offices:
Income Tax Building
1955 Smith Street
Regina, Sask. S4P 2N9
Phone: 780-6015

Canadian Imperial Bank of Commerce Building
201-21st Street East
Saskatoon, Sask. S7K 0A8
Phone: 665-4595

3. CCH Canadian Limited
Sells books and pamphlets on various income tax topics and issues an annual guide to filing income tax returns.
- One useful booklet is "Preparing Your Income Tax Return"
- Free publication list is available

CCH Canadian Limited

6 Garamond Court
Don Mills, Ontario M3C 1Z5
Phone: (416) 427-2992

4. Appraisers
Provide Valuation Day Values and current market values on a fee-for-service basis. A list of appraisers is available from the Appraisal Institute of Canada.

Appraisal Institute of Canada
502-177 Lombard Avenue
Winnipeg, Man. R3C 0W5

5. Other Information Available to Individual Farmers
Local Chartered Accountants and General Accountants
- Income tax filing, and individual counselling on all tax related matters. Lawyers
- advice on legal aspects

Wascana Institute, University of Saskatchewan, Community Colleges
- Sponsor courses in taxation
- Bookstores
- Books available on taxation

Glossary of Tax Terms

Accrual Method	The method of accounting required for tax filing by most non-farm businesses. Inventory changes and Accounts Payable and Receivable are used in the calculation of income. Income and expenses are entered when incurred,not when actually received or paid.
Adjusted Cost Base	The beginning value of an asset from which a capital gain or capital loss is calculated. It is generally the purchase price of an asset acquired since 1971, or the 1971 value for assets acquired in 1971 or before.
Annuity	A contract which obliges the issuing company to make equal installment payments to the owner at least once per year for a given number of years or for the owner's life.
Arm's Length	You are said to deal at arm's length if you deal with a stranger.
Attribution Rule	A rule which states that a taxpayer must include in his income any rental, capital gain, dividends or interest from property he gifts to his spouse or to minor children.
Averaging	Using tax provisions to spread out income over a number of years and thus reduce the total tax payable.
Basic Herd	A designated number of a given type of livestock to which additions were non- deductible and from which sales were non- taxable. Basic herds could only be established before 1972.
Bonafide Farmer	A farmer for whom farming, or farming in combination with some other income source, is his major income.
Capital Cost Allowance	The annual deduction allowed under the Income Tax Act to charge the costs of depreciable assets over a number of years.
Capital Gains and Losses	The change in value of an asset from the time it is acquired to the time it is disposed of.
Cash Method	The method of accounting that farmers and fishermen may use when filing farming and fishing income for tax purposes. Expenses and income are entered only when actually spent or received.
Comparable Sales	Information on similar property sold at a particular time and in a particular area - used to evaluate another similar property.
Debtor's Gain	An amount owing which is written off without payment. It is subject to special tax rules which in effect make it taxable to the debtor.
Declining or Diminishing Balance Method (Part XI)	The only method of calculating capital cost allowance for assets purchased since 1971. The allowance is always calculated as a percentage of the undepreciated capital cost remaining from the previous year.
Deduction	An amount which may be subtracted from income for the calculation of taxable income.
Deferral	Using tax provisions to reduce taxable income in a current year and put it off into the future.
Depreciable Assets	Assets such as buildings or machinery which depreciate in value. These can be entered onto capital cost allowance schedules.
Depreciation	The decline in value of an asset over time due to wear, tear and obsolescence.

Dividend	A payout of after tax profits by a corporation or co-operative to shareholders based on the number and type of shares they own.
Eligible Capital Expenditures	Refers to special tax rules and provisions which relate to "goodwill" and government rights and licences.
Exemptions	Tax-free status for given levels of certain types of income or for special situations.
Expenses	A deduction from income for costs incurred to produce that income (e.g. purchased seed cost is an expense to produce grain).
Fair Market Value	The value of an asset at a given date if sold by a willing and informed sell or to a willing and informed buyer who are unrelated.
Goodwill	Refers to intangible factors useful in producing income (e.g. where a business name with a good reputation is sold as part of the business).
Hobby Farmer	A farmer whose farm is not expected to produce a profit.
Income	Money and other valuable consideration (see "Taxable Benefits") received from sale of business produce, as a return on investment, as rental, or as wages, commissions or salaries for services performed.
i) Gross Farm Income	Total sales of farm products plus the value of products the farmer produces and consumes.
ii) Excess of Income over Expenses	Gross farm income minus farm expenses and a deduction for capital cost allowance.
iii) Net Income from Farming	Excess of income over expenses after division of income among partners, if any.
iv) Taxable Income	Net income from farming plus net income from other sources minus deductions and exemptions.
Income from Property	Income such as rentals, dividends, interest and capital gains.
Investment Tax Credit	A deduction from federal income tax payable for purchasing new buildings and machinery.
Involuntary Disposition	Disposing of an asset unintentionally due to destruction or expropriation. It is subject to special tax provisions.
Median Rule Method	One way of calculating the adjusted cost of an asset owned before 1972. The adjusted cost base is considered to be the middle of three values, the original price, the 1971 value, and the sale price.
Non-Arm's Length	People related by blood, marriage or adoption deal at non-arm's length. The term also applies between a shareholder and the corporation he holds a controlling interest in.
Non-Capital Losses	A loss incurred in a year of operating a business (i.e. when business expenses, including capital cost allowance, are greater than the business income).
Non-depreciable Assets	Land is a non-depreciable asset. It does not diminish in value over time as a result of use or obsolescence. It cannot be entered into the capital cost allowance schedule.
Optional Inclusion of Value of Livestock on Hand	A tax provision which allows a farmer to defer Livestock on Hand expenses by adding to his farm income for any year, an amount up to the fair market value of his livestock on hand. This amount must be shown as a deduction in the following year but the procedure may be repeated indefinitely from year to year.

Part XI Method, Part XVII Method	Part XI is the "declining balance" method and Part XVII is the "straight line" (pre-1972) method of calculating capital cost allowance.
Part-time Farmer	A farmer whose farm is capable of producing a profit, but for whom farming, neither alone nor in combination with some other income source, is his main source of income.
Principal Residence	A taxpayer's main house (he can have only one at a time). It is exempt from capital gains taxation.
Proceeds of Disposition	Sale price. It may be actual or in some cases, deemed (assumed).
Recapture	When a declining balance capital cost allowance class is sold out or becomes worth less than zero dollars, the amount less than zero dollars is "recaptured" as taxable income.
Registered Savings Plans	Registered retirement savings plans, and registered education savings plans are registered with Revenue Canada. Special tax provisions give these plans tax exemption or deferral status with regard to contributions and withdrawals.
Restricted Farm Losses	The farm losses that a part-time farmer may not deduct from other income in a particular year.
Rights and Things	Certain assets in an estate, subject to special tax provisions (e.g inventories, unclipped bond coupons).
Rollover	A transfer of an asset in such a way that the transferor is not taxed and the transferee is left in the same tax position as the transferor was before the transfer.
Straight Line Method (Part XVII)	A method of calculating capital cost allowance on assets acquired before 1972. The allowance is always calculated as a percentage of the original purchase price of the asset.
Taxable Benefit	Receiving non-cash consideration of value, instead of income (e.g. housing, farm feed or produce, use of vehicle, pension plan, services).
Tax-free Zone Method	Another name for the "median rule method".
Tax Rates	The percentage of taxable income that is payable as tax.
i) Average Rate	Total tax payable as a percentage of total taxable income Marginal Rate The tax rate applicable to the last dollar of taxable income.
ii) Terminal Loss	When a capital cost allowance class under the declining balance method is sold out and an amount remains - this amount is deductible as a "terminal loss."
Undepreciated Capital Cost	The remaining "book" value of a depreciable asset (straight line method) or a class of depreciable assets (declining balance method) at any given time.
Valuation Day (V-day) Value	The value of assets on December 31, 1971 (December 22, 1971 for publicly traded shares). This is usually used as the adjusted cost base of assets owned before 1972.